



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL



THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL **2005 COMPREHENSIVE ANNUAL FINANCIAL REPORT**

*A Constituent Institution of the University of North Carolina System and a Component Unit of the State of North Carolina
Fiscal Year Ended June 30, 2005
Chapel Hill, North Carolina*



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INTRODUCTORY SECTION

Snow covers the north end of McCorkle Place, close to Franklin Street.

MESSAGE FROM THE CHANCELLOR

If there is one thing I have learned in my travels to nearly 50 communities last year around the state, it is this: our University is deeply engaged in the issues that matter most to North Carolinians—their health, their economy, and their education.

We aspire for the University of North Carolina at Chapel Hill to become the nation's leading public university. We want Carolina to be the best that it can be. In setting our sights so high, we are drawing upon our past as the nation's first public university and our deep commitment to helping make North Carolina successful in the future. Our campus community, alumni, friends, and key volunteers embrace this ambitious vision for Carolina.



Recent accomplishments show we are pointed down the right path for success. In fall 2005, the University enrolled the most academically prepared first-year class in our history. Nearly 10 percent of these students (346) were in our

JAMES MOESER has served as the chancellor of the University since 2000.

second class of Carolina Covenant Scholars. An unprecedented \$1.5 billion construction and renovation program, believed to be the largest capital program on any U.S. campus, is making rapid progress. Over the past decade, faculty research funding has increased significantly, affirming our status among the national research leaders in health care, science, and technology. Alumni and friends are giving generously to the Carolina First Campaign, whose volunteer leaders increased the goal to \$2 billion.

Carolina is moving forward with tremendous momentum. Our challenge is to sustain that energy and focus it to best serve the people of North Carolina. Following are details about a few recent developments.

Carolina Covenant, Access, and Affordability

We were the first major American public university to promise a debt-free education to low-income students. The Carolina Covenant, now in its second year, is for eligible students and families at or below 200 percent of the federal poverty level. That covers a family of four making \$37,000 annually or a single parent with a child at \$24,000. We created a faculty volunteer mentor program so these students receive the support they need. Total attrition after our first year was less than 2 percent, a tribute to our first Carolina Covenant Scholars.

Carolina led the reversal of a national trend in which many universities diverted funds from need-based to merit-based programs to compete for high-ability students. We challenged other campuses to make similar investments to ensure affordability and access for deserving students. Many responded including Virginia, Maryland, Michigan, Nebraska, Illinois, Harvard, and Brown. Serving these students remains part of the national debate about accessibility, and we are often asked to share Carolina's perspective with national colleagues.

Few universities can declare, as we do, that they meet 100 percent of the demonstrated financial need of their students. Through the Carolina Covenant and an excellent overall financial aid program, we are making college possible for qualified students without regard for family income. This commitment stems from strong state funding for financial aid across the UNC System as well as our own Board of Trustees' policies, which stress extensive need-based aid (35 percent to 40 percent) when campus-based tuition rises.

Students from middle-class families do not bear the burden of higher tuition and costs. We meet all of their need. Average debt among graduating seniors who borrowed was \$11,751 in 2004. In 2003, that number was \$11,519, down from \$13,700 in 2000. Less than a quarter of our graduating students accumulated debt. By contrast, the nation's average student debt loan doubled to \$18,900 in about a decade.

Our practices protect access and affordability. Among our undergraduates, 33 percent received need-based financial grants in 2004–05. We met two-thirds of our undergraduates' need with scholarships and grants and the remaining third with loans and work-study jobs. Traditionally, aid packages on other campuses are closer to two-thirds loans and one-third grants.

Enhancing Service to North Carolina Aim of New Task Force

What is the role of a great university in a state that must compete in a global economy? If there is one thing I have learned in my travels to nearly 50 communities last year around the state, it is this: our University is deeply engaged in the issues that matter most to North Carolinians—their health, their economy, and their education. In every place I have visited I have seen our students, faculty and staff making a difference and touching people's lives.

The Institute of Government, the Area Health Education Centers Program and the Carolina Center for Public Service are wonderful examples of our engagement with North Carolina.

But we can do more to match our resources with the state's needs. We have convened a Chancellor's Task Force on Engagement, and senior campus officers and leaders have joined me to consider new ways to mobilize resources. One special focus is

K-12 education and how we can help the state's schools achieve dramatic gains in teaching and learning for all children. Other areas of emphasis include health care and economic development.

Faculty Compensation Remains Top Priority

Our number one priority remains attracting and retaining the finest faculty. As we benchmark ourselves against our national academic peers, we have worked hard to make up lost ground—to stay competitive with America's and now the world's best universities.

Last year, we raised money for 25 new endowed faculty chairs through the Carolina First Campaign. The General Assembly generously appropriated \$8 million in recurring funds across the UNC System to match these gifts and doubled the amount to be matched by the state. Our share of these new state funds totaled \$4.3 million, clearing the way for 18 of the 25 new chairs to be fully funded.

Carolina First Aims Higher—\$2 Billion

The overwhelming success of our Carolina First Campaign is a tribute to the passion that our alumni and friends have for this University. In October 2005, our campaign steering committee increased the campaign's goal from \$1.8 billion to \$2 billion to support the University's vision of becoming the nation's leading public university.

Now Carolina is one of just eight American universities seeking campaign goals of at least \$2 billion. At this writing, Carolina First has secured more than \$1.56 billion, 78 percent of the new goal, while being about three-quarters complete. We have created

151 endowed professorships for faculty and 523 scholarships and fellowships for students with funds that are part of the \$628 million that has been raised in gifts and pledges for the University's endowment. Donors have made possible new research, new academic programs and initiatives, and helped pay for renovating and building new facilities. In setting the goal \$200 million higher, we are focusing on faculty support, merit-based scholarships, and capital projects, the three most pressing priorities to keep Carolina competitive with our peers.

Faculty Research Funding Key to Future Success

Faculty research pumps hundreds of millions of dollars into the North Carolina economy and creates jobs through new products and spin-off companies. The faculty attracted \$579 million in total contract and grant funding in fiscal 2005—up slightly. The National Institutes of Health is our central funding source, and we ranked 15th overall in 2004 with nearly \$290 million.

This fall, Carolina became the nation's only university to receive eight grants in the NIH "Roadmap for Medical Research" initiatives. This effort encourages researchers to attack complex problems using interdisciplinary collaboration and sophisticated computational techniques to create quick translations to patient care.

CAMPUS BEAUTY *The beauty of the Carolina campus is one of the University's major assets. The American Society of Landscape Architects selected the Carolina campus as one of the most beautifully landscaped spots in the country. That listing is typical of the praise the University receives affirming the charm of mighty oaks, majestic quadrangles, brick sidewalks, and other landscaping synonymous with Carolina.*



Following Carolina were Vanderbilt and Columbia, with six; Memorial Sloan-Kettering Cancer Center with five; Johns Hopkins at four; Harvard and Stanford with three; and Duke with two. Our funding so far totals \$15.5 million and includes starting the Carolina Center of Nanotechnology Excellence, which will marry expertise in nanotechnology with patient research at the UNC Lineberger Comprehensive Cancer Center. Last year, Carolina also received three of the 21 initial Roadmap grants—more than any other university.

Major construction projects completed; cancer hospital breaks ground

We have reached several milestones with the construction program over the past year. Here is a sampling of recent highlights:

- Memorial Hall, resplendent after a three-year, \$18 million transformation, reopened in September 2005 with the



BREAKING GROUND Three-year-old cancer patient Reece Holbrook demonstrates his shovel skills at the groundbreaking for the North Carolina Cancer Hospital. Joining Reece were Chancellor James Moeser, State Senator Jeanne Lucas, and Dr. Richard Goldberg. The new hospital will bring complete cancer care for patients and research facilities into one building.

launch of an exciting new Carolina Performing Arts Series featuring over 700 artists. We have set a goal of a \$10 million endowment to support this high level of program quality. A challenge grant of \$5 million from the William R. Kenan, Jr. Charitable Trust will help us realize this objective.

- The Michael Hooker Research Center more than doubled the School of Public Health's research space with 31 new laboratories as well as high-tech conference rooms and classrooms. Faculty and students there are studying the link between nutrition and cancer risks, protecting the safety of our air and drinking water and searching for vaccines for infectious diseases.
- Rams Head Center, a multi-purpose facility adjacent to Kenan Stadium, offers a student recreation facility, excellent dining opportunities, and a parking deck all built as part of a state-of-the-art, environmentally friendly complex. Rams Head is an important step in transforming the southern region into an integral part of campus.
- We opened the Baity Hill and Mason Farm communities, located behind the Dean Smith Center, to house student families, many of whom are graduate students and postdoctoral students serving as teaching assistants. These facilities replace Odum Village, now a transition space while residence halls are renovated.
- We broke ground for the North Carolina Cancer Hospital, which will become a world-class hospital for cancer patients and their families from North Carolina and beyond. The new hospital will bring complete cancer care for patients and research facilities into one building and serve as the new clinical home for the UNC Lineberger Comprehensive Cancer Center. The General Assembly authorized \$180 million to build this facility during the 2004 session.

Conclusion

2004–2005 was another successful year in Chapel Hill. We made excellent progress. Working closely with our trustees, we have set solid priorities that address our overarching vision of becoming America's leading public university. The people of North Carolina and beyond deserve nothing less. We strive to ensure that everything our students, faculty and staff do—through teaching, research and public service—supports the objective of creating a model public university.

Sincerely,

James Moeser
UNC Chancellor

LETTER OF TRANSMITTAL

November 30, 2005

To Chancellor Moeser, Members of the Board of Trustees, and Friends of The University of North Carolina at Chapel Hill:

We believe the information is accurate in all material respects and fairly presents the University's financial position, revenues, expenses, and other changes in net assets.

We believe our system of internal controls is sound and sufficient to disclose material deficiencies in controls to the auditors and the audit committee.

Introduction

This Comprehensive Annual Financial Report includes the financial statements for the year ended June 30, 2005, as well as other useful information that helps ensure the University's accountability to the public. Responsibility for the accuracy of the information and for the completeness and fairness of its presentation, including all disclosures, rests with the University's management. We believe the information



NANCY SUTFENFIELD has served as vice chancellor for finance and administration for the University since 2000.

is accurate in all material respects and fairly presents the University's financial position, revenues, expenses, and other changes in net assets. We believe our system of internal controls is sound and sufficient to disclose material deficiencies in controls to the auditors and the audit committee. The Compre-

hensive Annual Financial Report includes all disclosures necessary for the reader to gain a broad understanding of the University's financial position and results of operations for the fiscal year ended June 30, 2005. The report is organized into three sections.

The Introductory Section includes a message from the chancellor, the transmittal letter, a listing of the University's Board of Trustees, Chancellor's Cabinet, and an organization chart. This section also features the University's major recent initiatives, priorities, and progress. Overall, this section provides background about the organization and structure of the University, the scope of its operations, significant factors contributing to the current fiscal environment, and expected factors influencing the future.

The Financial Section presents management's discussion and analysis, basic financial statements, and a report of the Office of the State Auditor. Management's discussion and analysis provides an objective review of the University's financial activities. The basic financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board.

The Statistical Section contains selected financial, statistical, and demographic information. This information provides a broad overview of trends in the University's financial affairs. Also included is historical statistical information reproduced from the 2004 Comprehensive Annual Financial Report. In addition, the Statistical Section contains information on the Cost of College Project of the National Association of College and University Business Officers.

The accompanying financial statements present all funds belonging to the University and its component units. While the 16-campus University of North Carolina System's Board of Governors has ultimate responsibility, the chancellor, the University's Board of Trustees, and the Board of Trustees of the Endowment Fund have both delegated and statutory responsibilities for financial accountability of the University's funds. For the fiscal year ended June 30, 2005, the University implemented Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. This statement amends GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, to establish and modify disclosure requirements related to investment risks: credit risk (including custodial credit risk and concentrations of credit risk), interest rate risk, and foreign currency risk. This statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk and foreign currency risk.

The financial reporting entity for the financial statements is comprised of the University and 10 component units. Although legally separate, The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (Investment Fund), UNC Investment Fund, LLC (System Fund), UNC Management Company, Inc. (Management Company), The University of North Carolina at Chapel Hill Foundation, Inc., The Kenan-Flagler Business School Foundation, The School of Social Work Foundation Inc., and U.N.C. Law Foundation, Inc. are reported as if they were part of the University.

The Investment Fund supports the University by operating an investment fund for charitable, non-profit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. The System Fund was organized to allow the University, the University of North Carolina and its constituent institutions (UNC System), affiliated foundations, associations, trust, and endowments that support the University and the UNC System to pool their resources and invest collectively in investment opportunities identified, structured and arranged by the Management Company. The Investment Fund contributed and assigned all of its assets to the System Fund in exchange for membership interest in the System Fund. At year end, the Investment Fund membership interest was approximately 93 percent of the System Fund total membership interest.

The Management Company is organized and operated exclusively to support the educational mission of the University. The Management Company also provides investment management services to the University, UNC System, and affiliated tax-exempt organizations. The purpose of UNC-CH Foundation, Business School Foundation, Social Work Foundation, and Law Foundation is to aid, support, and promote teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the University.

The financial statements of the Investment Fund, System Fund, Management Company, UNC-CH Foundation, Business School Foundation, Social Work Foundation, and U.N.C. Law Foundation have been blended with those of the University.

Separate financial statements for three other component units are reported based on GASB Statement No. 39. The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. are legally separate, not-profit, tax-exempt organizations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

Other related foundations and similar non-profit corporations for which the University is not financially accountable are not part of the accompanying financial statements. The University of North Carolina at Chapel Hill is a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's Comprehensive Annual Financial Report.

Economic Condition and Outlook

According to a June 23, 2005, release from the Bureau of Economic Analysis (BEA) of the U.S. Department of Commerce, the gross state product (GSP) of North Carolina in 2004 was \$335.4 billion or 2.9 percent of the total \$11.6 trillion for the entire U.S. The North Carolina increase was 6.3 percent from 2003, which was slightly below the 6.6 percent national average. This result meant that North Carolina was the 11th largest economy among all states in 2004. Georgia was 10th at \$340.7 billion and Virginia was 12th at \$326.6 billion.

Total personal income in North Carolina was \$250.3 billion in 2004, according to a BEA release of September 28, 2005. This was an increase of 6.7 percent from the revised \$234.5 billion of 2003. This increase was well above the 6 percent national average. The BEA release indicated that personal income in North Carolina was running at a seasonally adjusted annual rate of \$265.8 billion in the second quarter of calendar year 2005. This was an increase of 7.4 percent from the second quarter of 2004, which compares quite favorably with the national average increase of 6.5 percent for the same period.

The state budget situation has been affected by the economy for over five years now. One big reason, which North Carolina shares with 20 other states, is that nonfarm payroll employment has

yet to recover from the 2001 recession. According to the Bureau of Labor Statistics (BLS) of the U.S. Department of Labor, total nonfarm payroll employment on a seasonally adjusted basis hit its all-time peak of 3,967,500 jobs in January 2001, which was just before the start of the recession in March. According to the BLS state and regional employment release of September 16, 2005, there were 3,892,300 such jobs in North Carolina in August 2005. This represents a decline of 75,300 jobs or 1.9 percent from the peak. Only five states (South Carolina, Illinois, Ohio, Massachusetts, and Michigan) have had a greater decline over the past four years than what North Carolina has experienced.

However, the employment picture from the household survey, a completely different measure of employment in the U.S., is much more optimistic. The previous peak was 3,989,425 people employed in January 2001 on a seasonally adjusted basis. That was first exceeded in December 2003 and every month since then has been above the previous peak. According to the September 16, 2005 BLS release, there were 4,095,572 people employed in North Carolina in August on a seasonally adjusted basis. That was 106,147 more people employed or a 2.7 percent increase from the January 2001 level. It was also up 57,772 people, or 1.4 percent, from August 2004.

The increase from the previous peak ranks North Carolina eleventh in the U.S. in total net employment gains over the post-2001 recession period, just below Nevada and just above Pennsylvania. This means that many more people have become self-employed in North Carolina over the past four years. The robust increases in personal income over this period suggest that most of them have been successful.

Consensus forecasts are for the U.S. economy to grow about 3.5 percent in real (adjusted for inflation) terms in calendar year 2006. North Carolina should manage real GSP growth of about 4 percent. That would be a welcome improvement in the overall economic situation.

Progress and Major Initiatives

Carolina's progress, priorities, and major initiatives during fiscal year 2004-2005 reflected the University's vision of becoming the nation's leading public university. Following this letter are highlights from fiscal year 2004-2005.

Financial Information

INTERNAL CONTROL STRUCTURE

The University's Finance and Administration Division establishes and maintains an effective system of internal control. One objective of an internal control structure is to provide management with reasonable, although not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition. Another objective is to ensure that transactions are executed in accordance with appropriate authorization and recorded properly in the financial records to permit the preparation of financial statements in accordance with generally accepted accounting principles. Organizational structure, policies, and procedures have

been established to safeguard assets, ensure the reliability of accounting data, promote efficient operations, and ensure compliance with established governmental laws, regulations and policies, University policies, and other requirements of sponsors to whom the University is accountable.

As a recipient of federal financial awards, the University is responsible for ensuring compliance with all applicable laws and regulations. A combination of state and University policies and procedures, integrated with the University's system of internal controls, provides for this compliance. As an integral part of the State of North Carolina's Single Audit, the University is subject to an annual examination by the Office of the State Auditor of its federal financial assistance programs and federal cost-reimbursement contracts in accordance with U.S. Office of Management and Budget Circular A-133, Audits of State and Local Governments, and Non-Profit Organizations.

The University determined a course of action as part of higher education's response to the Sarbanes-Oxley Act and has implemented practices to enhance the internal control structure. The University's focused effort on financial controls provides a more proactive and broader approach in identifying and resolving potential limitations on sound internal control through a self-assessment process, development of a professional code of ethics, targeted campus training sessions, special reviews, improved documentation of internal controls, and timely and useful responses to questions from campus units. A financial controls manager leads efforts to strengthen and maintain sound internal controls. The Audit and Finance Committee of the Board of Trustees maintains an Audit Committee charter consistent with higher education standards.

BUDGETARY CONTROLS

The University is responsible for controlling its budget and using the funds to fulfill its educational, research, and public service missions. It is also responsible for planning, developing, and controlling budgets and expenditures within authorized allocations in accordance with University, state, and federal policies and procedures. The University maintains budgetary controls to ensure compliance with provisions embodied in the annual appropriated budget approved by the North Carolina General Assembly, and as further directed by the Board of Governors. Project-length financial plans are adopted for capital projects.

After the budget has been approved by the chancellor and the Board of Governors, the University follows an established system of budgetary controls. Finance and Administration issues periodic interim budget statements to department heads to guide them in managing their budget allocations. Monthly financial reports are provided on each fund to individual managers responsible for the fund. Financial reports are also provided to the state. When actual conditions require changes to the budget, revisions are prepared, and these revisions are appropriately approved and communicated to those affected. Changes to the budget are approved at the University level and/or the state level as required. Based on the state's management flexibility legislation, the University

has received delegated authority for designated budget changes. The University maintains an encumbrance accounting system as another method to ensure that imposed expenditure constraints are observed.

DEBT ADMINISTRATION

To ensure the appropriate mix of funding sources is utilized, the University established a debt policy, which is continuously used by management as a tool to evaluate the University's organizational and capital funding structure, the appropriate use of leverage, and internal lending mechanisms.

To fulfill its mission, the University will need to make capital investments, driving capital decisions that affect the University's credit. Appropriate financial leverage serves a useful role and should be considered a long-term component of the University's balance sheet. Just as investments represent an integral component of the University's assets, debt is viewed to be a continuing component of the University's liabilities. Debt, especially tax-exempt debt, provides a low-cost source of capital for the University to fund capital investments and achieve its mission and strategic objectives.

The debt strategies, combined with management judgment, provide the framework by which decisions will be made regarding the use and management of debt. The objectives of the debt policy are:

- Identify projects eligible for debt financing. Using debt to fund mission-critical projects will ensure that debt capacity is optimally used to fulfill Carolina's mission. Projects that relate to the core mission will be given priority for debt financing; projects with associated revenues will receive priority consideration as well.
- Maintain Carolina's favorable access to capital. Management's determination of the timing of capital projects will not be compromised by the University's access to capital sources, including debt. Management will use and issue debt to ensure timely access to capital.
- Limit risk of University debt portfolio. The University will manage debt on a portfolio basis. The University's continuing objective to achieve the lowest cost of capital will be balanced with the goal of limiting exposure to market shifts.
- Manage the University's credit to maintain the highest acceptable credit. This practice will permit the University to continue to issue debt and finance capital projects at favorable interest rates while meeting strategic objectives. The University will limit its overall debt to a level that will maintain an acceptable credit rating with the bond rating agencies.

In meeting these objectives, the University has adopted strategies and procedures for the management of its debt. These strategies include the following:

- **Mission-Based Capital Planning.** Provide framework with a link to mission to evaluate and prioritize debt-eligible projects.
- **Core Ratios.** Adopt a set of core ratios to guide capital planning and ensure central oversight of University-wide leverage levels.
- **Financial Instruments.** Provide management with appropriate debt vehicles based on borrowing needs.
- **Asset/Liability Management.** Manage outstanding debt and future debt-financing needs within the framework of sound portfolio management practices.

The University has \$456.1 million of outstanding long-term bonds and \$141.1 million of commercial paper at June 30, 2005. The bonds were issued to finance the construction and/or renovation of many campus facilities including essential new research buildings, major new cultural facilities that will benefit the local community and state, undergraduate residence halls, student family housing, and parking facilities. Principal and interest for the bonds are payable from the general revenues of the University – excluding state appropriations, tuition, restricted gifts and restricted income from endowment investments – and net revenues generated by the operations of the debt-financed facilities.

The UNC-CH Foundation, which is part of the University's financial reporting entity, also adheres to a debt policy that maximizes the utility of the foundation's financial resources to continue to provide current and future support to the University.

CASH MANAGEMENT

The cash management plan of the University provides guidance to ensure control and deposit of receipts, appropriate management of disbursements, and investment of funds to maximize earnings on the investment of cash and minimize nonproductive cash balances. State law requires that state-appropriated funds be deposited and invested with the State Treasurer with investment earnings accruing to the state. Other resources, such as gifts, contract and grant awards, auxiliary revenues, and student activity fees are not appropriated by the state. These funds, except for fees from services of health-care clinics, must be deposited and invested with the State Treasurer with investment earnings accruing to the University. Endowment, debt service, fees from services of health-care clinics, and other designated funds are invested by the University in accordance with its investment policies.

The University administers a short-term investment pool for funds not required to be on deposit with the State Treasurer. The investment pool is administered in conjunction with cash receipts and disbursing requirements to minimize idle cash and to generate current income without loss of capital at a rate of return no less than the State Treasurer. Earnings are distributed

to participating funds.

The objective in managing disbursements is to maintain funds in interest-bearing accounts for the longest appropriate period of time while ensuring that payments for goods and services are made timely. Disbursement cycles are established to coincide with this objective. The University uses the state's cash management control system to improve cash flow by electronically recording cash receipts and disbursements for funds deposited with the State Treasurer. Other electronic processes have been developed for the receipt and disbursement functions to provide efficient and effective processes.

RISK MANAGEMENT

Risk has traditionally been viewed as something to be avoided or eliminated with only a negative outcome. Increasingly in today's environment, risk is more broadly defined as any issue that affects an organization's ability to meet its objectives. There is also greater awareness that responsible risk taking leads to a competitive advantage and can maximize stakeholder value.

To optimize the benefits of risk and minimize their costs, the University has taken a more enterprise-wide approach to its risk management programs by holistically addressing its operational, financial, compliance, strategic and reputation risks. This enterprise risk management framework ensures that decisions that trade value and risk are made on an informed basis and are aligned with our risk tolerance and strategy. Addressing our full portfolio of risks is also a critical element of our strategic planning process. During the past year, the Enterprise Risk Management Advisory Committee began assessing the University's most critical risk drivers. This ongoing process allows us to prioritize and efficiently use our risk management resources.

Included within this enterprise risk management framework is our responsibility to mitigate any business interruption that adversely affects our education, research, and public service missions. An effective campus-wide continuity plan is central to this responsibility. Therefore, the committee's charter has been expanded to include a Business Continuity Plan. Moving forward, we intend to build from our past business continuity success and develop a more robust, campus-wide Business Continuity Plan.

Insurable risks are addressed in several ways, including participation in various state-administered risk pools, purchase of commercial insurance, and self retention of certain risks. Refer to Note 14 of the Notes to the Financial Statements for more detailed information concerning the University's insurance programs.

Other Information

AUDITS

State law, federal guidelines, and certain bond covenants require that the University's accounting and financial records be audited



CERTIFICATE OF ACHIEVEMENT *Ten-time winner of reporting excellence.*

by the Office of the State Auditor each year. The University's Internal Auditors also perform fiscal, compliance, and performance audits. The reports resulting from these audits are shared with University management. Internal and external audit reports are provided to the Audit and Finance Committee of the Board of Trustees.

The audit of the University's federal financial assistance programs is performed by the Office of the State Auditor in conjunction with the statewide Single Audit. The accounting and financial records of The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc., The University of North Carolina at Chapel Hill Foundation, Inc., UNC Investment Fund, LLC, UNC Management Company, Inc., The Kenan-Flagler Business School Foundation, The School of Social Work Foundation, Inc., The U.N.C. Law Foundation,

Inc., the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, WUNC Radio, and the Athletic Department are each audited by a public accounting firm in addition to the State Auditor review. All audit reports are available for public inspection.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the University for its comprehensive annual financial report for the fiscal year ended June 30, 2004. This was the 10th consecutive year that the University has been honored with this prestigious award. To receive a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for one year. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGMENTS

Preparation of this Comprehensive Annual Financial Report in a timely manner would not have been possible without the coordinated efforts of the University community, with special assistance from the Chancellor's Office, the Office of the Executive Vice Chancellor and Provost, Research and Economic Development, Student Affairs, Information Technology Services, University Advancement, University Relations, Institutional Research, the Office of Scholarships and Student Aid, the Department of Athletics, and Dr. James F. Smith, Adjunct Professor of Business Administration in the Kenan-Flagler Business School. In addition, the Office of the State Auditor provided invaluable assistance.

Nancy D. Sattenfield
Vice Chancellor for Finance and Administration

PROGRESS AND MAJOR INITIATIVES: FISCAL 2004-2005

Carolina's progress and *major initiatives* during fiscal 2004-2005 reflected the vision of *becoming the nation's leading public university*. Following are a sampling of recent highlights *demonstrating* significant *progress* across many different areas of the University:

Carolina Covenant: Evolving as a National Model

In fall 2005, the University enrolled its second class of 346 Carolina Covenant Scholars, who represent nearly 10 percent of the total first-year class. Their enrollment followed an excellent first year for this program in which students posted less than a 2

percent attrition rate. The University also started a mentorship program for Covenant scholars that is being strongly supported by faculty volunteers.

Carolina Covenant scholars are admitted under the Carolina's rigorous admissions standards. Incoming Covenant students in 2005 posted an average 4.06 grade-point average and 1,222 Scholastic Aptitude Test score. That compares favorably with the rest of the 2005 class, the most academically prepared in UNC history.

Those developments follow the University's expansion of this nationally recognized initiative to make a debt-free college education possible for more low-income students. The changes, announced by Chancellor James Moeser during his 2004 State of the University address, send an even stronger message about accessibility and the traditional commitment to opportunity in Chapel Hill for qualified students—regardless of their ability to pay.

Launched in fall 2004, the Carolina Covenant initially covered 224 freshmen (over 8 percent of the entering first-year class). Covenant students can graduate without debt. Instead, they agree to work on campus 10 to 12 hours weekly in a federal work-study job, and Carolina meets the rest of their needs through a combination of federal, state, University, and other privately funded grants and scholarships.

Beginning in fall 2005, students and their families must be at or below 200 percent of the federal poverty level—up from 150 percent. That raises the threshold to cover a family of four with an annual income of about \$37,000 or a single parent with a child who makes about \$24,000. In the program's first year, those



FUTURE CARDIOLOGIST “I am the first in my family to go to college. My aunt always told me, ‘You can make it.’ She encouraged me to excel in school and to do something to give back to the community, and her message was a powerful one. That is why I am interested in medicine. I think I’d like to be a cardiologist. After I graduate, I’m thinking of working in North Carolina so I can help the growing immigrant population and those who don’t speak English. Shirley Ort of UNC’s Office of Scholarships and Student Aid told me that I had been chosen for the Carolina Covenant. When she showed me my financial aid package, I almost cried to learn that everything had been planned for me, and that I could graduate with no debt. I had no idea that UNC had so many opportunities for students like me. The Carolina Covenant is a great opportunity for students who don’t have access to a lot of financial resources. Students have more of a feeling of security because they can pay for college while they’re in college, and not wait until they graduate to pay off their debt.”

Nayeli Lozada, Class of 2008
Carolina Covenant Student

income levels were at about \$28,000 and \$18,000, respectively.

Carolina was the first major public U.S. university to announce plans for such a program in fall 2004. Since then, several universities, including Virginia, Maryland, Nebraska, Illinois, Harvard, and Brown have created or announced plans for similar programs.

The University consistently ranks among the national leaders in making education financially accessible to students. Carolina also meets the full need of middle-income students, with financial aid packages comprised of two-thirds grants and scholarships and one-third loans and work-study. (Most aid packages are closer to two-thirds loans and one-third grants.)

Average debt among graduating seniors who borrowed was \$11,751 in 2004. In 2003, that number was \$11,519, down from \$13,700 in 2000. Less than a quarter of the University's graduating students accumulated debt. By contrast, the nation's average student debt loan doubled to \$18,900 in about a decade.

In 2005, the Board of Trustees approved devoting all proceeds from the sale of trademark-licensed University products (such as T-shirts and caps bearing the Tar Heel logo) to scholarships and financial aid. Previously, 75 percent of these funds had already been dedicated to need-based aid, providing much of the foundation for the Carolina Covenant. The rest of these funds are being dedicated to new merit-based scholarships. That action created 59 merit-based scholarships, and 53 of those were awarded to North Carolinians. Carolina saw an immediate increase—slightly more than 4 percent—in the yield rate of admitted North Carolina students deciding to attend Carolina.

Carolina First: Aiming Higher With New Goal



The Carolina First Campaign is a comprehensive, multi-year private fund-raising campaign—the largest in the University's history—to support the vision of Carolina becoming the nation's leading public university.

In October 2005, the campaign steering committee increased the goal from \$1.8 billion to \$2 billion. Now Carolina is one of just eight American universities seeking campaign goals of at least \$2 billion. The others are UCLA, the universities of Chicago, Michigan, Virginia, and Washington, as well as Johns Hopkins and New York universities. Institutions completing campaigns of \$2 billion or more since 1999 are Columbia, Duke, and Harvard universities, the Massachusetts Institute of Technology, and the University of Southern California.

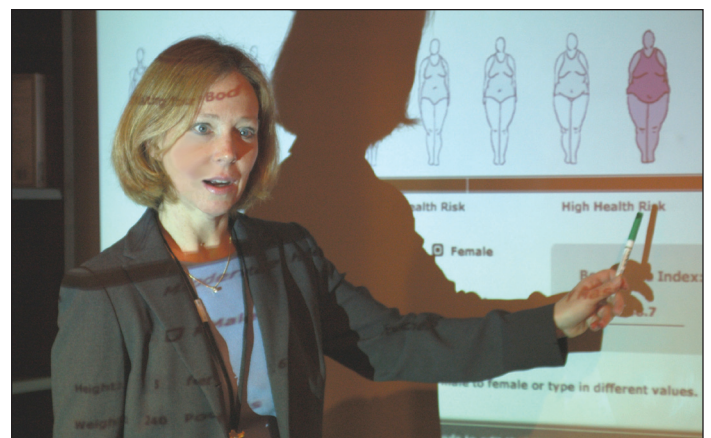
By October 2005, Carolina First had brought in \$1.56 billion, 78 percent of the new goal, while being about three-quarters complete. The campaign created 151 endowed professorships for faculty toward a goal of 200, and 523 scholarships and fellowships for students out of the goal of 1,000. Those funds are part of the gifts and pledges that include \$628 million to be added to Carolina's endowment. Generous donors have funded new faculty

research, new academic programs and initiatives as well as new buildings and renovations. In setting the Carolina First Campaign goal \$200 million higher to \$2 billion, the University is focusing on faculty support, merit-based scholarships, and capital projects. These are the three most pressing priorities that affect Carolina's ability to compete with peer campuses.

Total giving in fiscal 2005 was \$192.5 million in gifts and private grants, breaking Carolina's single-year record of \$192.4 million, set in 2004. This total counts only cash and assets received outright. Including pledges and deferred gifts, commitments totaled \$244.8 million, topping 2004's \$236 million.

Major gifts and pledges announced in fiscal 2005 included:

- \$3 million from Charlie Loudermilk, chairman and chief executive officer of Aaron Rents, Inc., to expand executive education facilities at the Rizzo Conference Center, part of the Kenan-Flagler Business School.
- \$600,000 from alumnus and former U.S. Ambassador Anthony S. Harrington and his wife, Hope. That completed a \$1.6 million endowment fund to support the Institute of Latin American Studies in the College of Arts and Sciences.
- \$2.37 million from the Gary W. Parr Family Foundation in New York City to establish the Parr Center for Ethics in the department of philosophy. Gary W. Parr, a 1979 alumnus, is deputy chairman of Lazard Freres & Co LLC, in New York. The Parr Center is the public face of the University's commitment to ethics.
- A \$7.1 million pledge from the Ithaca, N.Y.-based Triad Foundation will fund the Roy H. Park Fellowship program



DISORDER SPECIALIST *The Carolina First Campaign brought Cynthia Bulik to Carolina as the William R. and Jeanne H. Jordan Distinguished Professor of Eating Disorders. She holds the nation's only endowed chair devoted to the study and treatment of eating disorders, and just one of two in the world. She also directs the Southeast's first comprehensive eating disorders program at UNC Hospitals.*

in the School of Journalism and Mass Communication from 2005-06 through 2009-10.

- The Charlotte-based Bank of America Foundation gave \$900,000 to the Carolina Covenant, as well as \$100,000 to the Center for Banking and Finance in UNC's School of Law. Pepsi Bottling Ventures LLC was another major contributor to the Carolina Covenant, providing \$1.5 million.
- The James M. Johnston Trust of Chevy Chase, Md., gave \$2.1 million to student aid programs.

For the eighth time in 12 years, the development office won the Council for Advancement and Support of Education/Wealth ID Award for superior fund raising. No other university—public or private—has won the award as many times.

Carolina First is the private complement to the generous public support that North Carolina's voters and legislators have shown for the University. In 2000 North Carolina voters approved \$510 million in bond funding for repair, renovations, utilities, infrastructure, and new buildings at Carolina. Carolina First is helping leverage that bond money by making good on Chancellor Moeser's pledge to state citizens to triple it through private gifts. In all, the University plans to invest another \$1 billion in non-state funds for additional buildings essential to continued excellence.

Campus Master Plan: Steering Rapid Growth

The campus master plan is guiding the next several decades of an aggressive renovation and building program at Carolina. The plan shows where and how to place future buildings. It identifies transportation and utility corridors and suggests ways to protect open space and meet key environmental standards covering topics such as storm water runoff. The plan also recognizes the importance of enhancing the intellectual climate and the valuable University culture of collegiality and collaboration.

Fiscal 2004-2005 marked the fourth year of master plan implementation. The Board of Trustees approved the plan in 2001 after three years of work involving the University, consultants, and Town of Chapel Hill representatives. Later joint town-gown discussions led to a new zoning ordinance and the rezoning of the main campus. A development plan approved by the town in 2001 included details on proposed development and strategies to mitigate community impacts. The University reached agreements with the town about two separate modifications to the campus development plan in 2003-2004.



BUILDING IN SUSTAINABILITY *Below: The common area in front of the new Rams Head Center combines key elements of the campus master plan including promoting a pedestrian-oriented campus. Underneath the quad lies state-of-the-art storm water management technology—another key aspect of the master plan's sustainability component. The center provides recreation, dining, and parking facilities as well as a grocery store. To the left: Sports Cafe in the Rams Head Center. Above: The Rams Head Center exterior.*



By mid-2005, the University had advanced the bond referendum project schedule to achieve completion six months ahead of the baseline target. Overall, the current construction program, exceeding \$1.5 billion, represents the equivalent of building Wake Forest University in the middle of the active Chapel Hill campus.

Related accomplishments included:

- 36 projects completed (21 percent of the total program) within budget and on schedule. Total value: \$310 million.
- 42 projects under way (50 percent of the program) all within budget, and 40 ahead of or on schedule. Total value: \$750 million.
- 64 projects in design (29 percent of the program). Total value: \$440 million.
- Cash flow met projections.

The University also began a process to update the campus master plan as the main campus approaches complete build out and finished a report of the Chancellor's Task Force on Landscape Heritage and Plant Diversity.

Other highlights included the following:

- The Historically Underutilized Business (HUB) Resource Center's participation rate is 14.6 percent overall, leading the UNC System. The University awarded \$120.24 million worth of HUB contracts.

LOOMING CRANE A tower crane looms over the construction site for the Global Education Center off McCauley Street. The center—the result of the Higher Education Bond Referendum and private gifts—is a visible and tangible symbol of the University's commitment to being engaged internationally.



- Continued emphasis on transportation strategies such as park-and-ride lots, fare-free transit, Zip Cars, and a nationally recognized commuter alternative program, for which participation continued to increase—by 25 percent in 2004–05 alone.
- Advanced key master plan projects, including Rams Head Center, a linchpin in the plan that combines a 700-space parking deck, dining and student recreation facilities, and innovative sustainability practices. Other recently completed projects include the Health Sciences Library, which will foster collaboration among scientists and educators, and Carington Hall, which doubled the School of Nursing's space and became the UNC System's first building to be certified for Leadership in Energy and Environmental Design by the U.S. Green Building Council.

- Ribbon-cuttings held in fall 2005 included the newly renovated Memorial Hall, the Michael Hooker Research Center in the School of Public Health, and the 440 West Franklin Street Building renovation. Ground also was broken for the North Carolina Cancer Hospital, a \$180 million facility being built by the UNC Health Care System.

- Other projects under way include: first phases of the Carolina Physical Science Complex; Global Education Center; renovation of Burnett-Womack and Medical Sciences Research Building addition and renovation (School of Medicine); Genetic Medicine Building (schools of medicine and pharmacy); student family housing; Campus Y; Infor-



ARTS HOME Memorial Hall, resplendent after a three-year, \$18 million transformation, reopened in September 2005 with the launch of an exciting new Carolina Performing Arts Series featuring over 700 artists. Violinist Itzhak Perlman, left, was among the performers during the reopening ceremonies.

mation Technology Services Building; and infrastructure improvements (chilled water, utilities, and steam plant).

Academic Plan: Guiding the Future

The University's strategic focus and priorities build upon the academic plan completed and endorsed by the Board of Trustees in 2003. The plan, developed through a campus task force, guides the University's decisions about investments in the academic enterprise in the short term. It is tied with parallel efforts to develop a rolling five-year financial plan, which tracks priority initiatives and projects expected costs and funding sources. These initiatives range from faculty compensation to library needs to information technology infrastructure improvements.

The academic plan's six key priorities are:

- Provide the strongest possible academic experiences for undergraduate, graduate, and professional students.
- Further integrate interdisciplinary research, education, and public service.
- Improve faculty recruitment, retention, and development.
- Increase diversity among faculty, students, and staff.
- Enhance public engagement.
- Extend Carolina's global presence, research, and teaching.

The plan is dynamic and will be reviewed and revised as new opportunities and challenges emerge. The Provost's Office complet-

ed an update summarizing action steps taken to follow through on plan recommendations in July 2005.

Faculty Research: Growing Excellence

Carolina faculty conduct research that creates new knowledge and useful technologies as well as pumps hundreds of millions of dollars into the North Carolina economy. These advances, combined with teaching and public service, make the University an educational and economic beacon for the state.

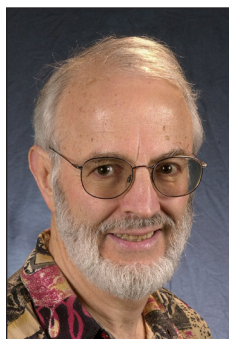
Research funding has risen steadily at Carolina for more than two decades, making Chapel Hill one of the top U.S. public universities in research support and creating jobs through new products and spin-off companies. The faculty attracted \$579 million in total contract and grant funding in fiscal 2005—up slightly. The National Institutes of Health (NIH) is Carolina's central funding source, and the faculty ranked 15th overall in 2004 with nearly \$290 million in total NIH funding.

Positive growth in the University's overall research funding corresponds with a decision made in mid-1998 by the North Carolina General Assembly to permit the University to retain all overhead receipts generated by research.

Ongoing research initiatives include efforts to tackle challenges such as genome sciences, which is unraveling the mysteries of DNA and the human genome. Carolina has committed at least \$245 million over a decade to be at the forefront of the genomics revolution. Led by renowned genetics scientist Terry Magnuson, the initiative represents a public-private investment that includes a \$25 million anonymous gift creating the Michael Hooker Center for Proteomics to study a specialized area of genetics. One result of the initiative is the

School of Public Health's selection by the U.S. Centers for Disease Control and Prevention to house one of three U.S. centers for excellence for genomics and public health.

Since 2000, the University has maintained a strategy of targeted investment in "big idea" research themes, knitting together existing strengths in various areas to create broad, interdisciplinary new thrusts.

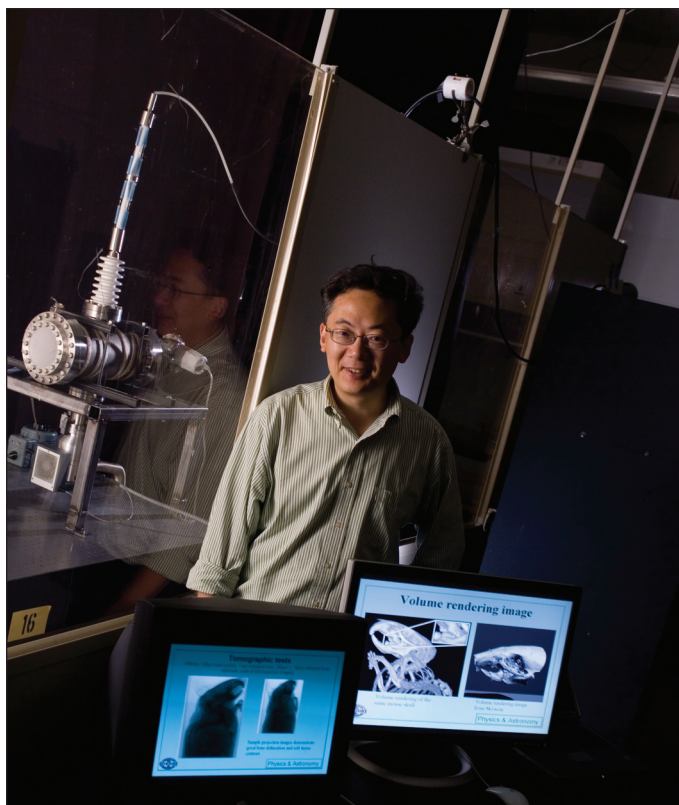


FACULTY EXCELLENCE Above: Dr. Barry M. Popkin, professor of nutrition, directs a new obesity center funded by the National Institutes of Health. The center represents part of Carolina's success in competing for research grants as part of the NIH's "Roadmap for Medical Research." Left: Assistant Professor Daniel Reichart, and his team of undergraduate and graduate students measured the distance of an explosion scientists determined to be the farthest ever detected: a gamma-ray burst from the edge of the visible universe. Junior Josh Haislip, far right, was the first to analyze the data from a telescope UNC helped build in Chile. Others, from left to right, were seniors Chelsea MacLeod and Justin Kirschbrown along with graduate student Melissa Nysewander.

Recent examples of key new interdisciplinary initiatives include:

- The Renaissance Computing Institute (RENCI), created by Chancellor's Eminent Professor of Computer Science Dan Reed, addresses problems spanning the sciences and engineering, the arts, the humanities, and commerce. RENCi, with broad collaboration with Duke, N.C. State, and the private sector, envisions multidisciplinary collaborations through the application of leading-edge technologies.

In the past year RENCi launched projects in ocean modeling, biology, medicine, and other disciplines with state and national collaborations. RENCi participated in a Duke-N.C. State-UNC proposal for a National Center for Evolutionary Biology that was funded by the National Science Foundation. In addition, RENCi proposed the Carolina Center for Exploratory Genetic Analysis that was funded by the National Institutes of Health. With support from the Office of the President, UNC created a bioinformatics portal to advance scientific discovery and biomedical education. RENCi partnered with the Health Sciences Library to create a high-performance visualization wall and collaboration facility in the newly renovated library—a first in the nation.



START-UP Xintek is one of Carolina's newest start-up companies spawned from faculty research and innovation. It is based on an invention by Otto Zhou, Lyle Jones professor of physics and materials sciences in the College of Arts and Sciences. He is developing a new method of medical X-ray imaging based on pulsed nanofibers. The system can capture images of the body or a specific organ while they are moving. The result is more precise and sensitive X-rays.

- The "Roadmap for Medical Research" initiative, intended to focus future NIH funding in 21 broad areas of concentration. The University established a Roadmap Office led by a faculty member to position the campus for the highest level of success. This NIH initiative encourages researchers to attack difficult problems using interdisciplinary collaboration and sophisticated computational techniques to create quick translations to patient care.

As a result of the work of the Roadmap Office and the strength of Carolina's faculty and their interdisciplinary work, Chapel Hill was the only university to receive eight of 21 grants in the fall 2005 Roadmap competition. This funding so far totals \$15.5 million and includes starting the Carolina Center of Nanotechnology Excellence, which will marry expertise in nanotechnology with patient research at the Lineberger Comprehensive Cancer Center. Last year, Carolina also received three of the 21 initial Roadmap grants—more than any other university.

- The Carolina Entrepreneurial Initiative, funded with a five-year, \$3.5 million grant from the Ewing Marion Kauffman Foundation is being matched two-to-one by the University. UNC is one of seven Kauffman Foundation-designated "Entrepreneurial Universities," chosen through a national competition. Carolina is deploying new programs to create a surge of entrepreneurship among students, faculty, and staff, including a new minor in entrepreneurship in the College of Arts and Sciences. The program is led by a team from an array of disciplines and managed by the Frank Hawkins Kenan Institute of Private Enterprise. Successful entrepreneurs, many of them alumni, are advisors, lending their real-world expertise.
- The Office of Economic and Business Development (OEBD) matches faculty and campus expertise and resources with economic development issues facing North Carolina and its communities and organizations. This office is led by Jesse White, Jr., who headed the Appalachian Regional Commission and the Southern Growth Policies Board.

During its first year of operations, OEBD worked within the University to develop a network of faculty interested in economic development work in North Carolina. It also worked on several economic development projects in the state, including Carolina's response to the state's successful bid to have Credit Suisse First Boston locate a major facility in the Research Triangle Park area. At the announcement ceremony, the company stated that the assets of North Carolina's universities were a deciding factor in locating in North Carolina.

Technology: Promoting Economic Development

Among the University's goals in the research arena are to transfer new technologies into the consumer marketplace, resulting in increased economic value for North Carolinians as well as income for inventors and the University.



CAROLINA NORTH *This artist's rendering shows a quad view of Carolina North, planned on University-owned land less than two miles from main campus. An economic impact study projects that completion of the first two phases of Carolina North will create over 7,500 permanent jobs. That means \$433 million in annual salary and personal income and \$600 million in annual business revenue.*

Key accomplishments included the following:

- Faculty filed 113 invention disclosures with the campus Office of Technology Development.
- 119 patent applications were filed, and 25 new U.S. patents were issued to the University. That brought the total of U.S. and foreign patents held by Carolina to 655.
- 31 inventions were licensed.
- Licensing income totaled \$1.98 million.

Among the recent, promising inventions from Carolina research is an experimental anti-HIV drug being developed by Panacos Pharmaceuticals. Phase II clinical trials have been successfully completed. The drug was developed by Carolina researcher Kuo-Hsiung Lee, Kenan professor of natural products in the School of Pharmacy. Its central compound was discovered in an herb grown in Taiwan but is also found in the bark of birch trees across North America.

Faculty discoveries and innovations have resulted in the creation of 25 UNC spin-off companies and about 281 jobs. For example, Otto Zhou, Lyle Jones professor of physics and materials sciences in the College of Arts and Sciences, is developing a new method

of medical X-ray imaging based on pulsed nanofibers. The system can capture images of the body or a specific organ while they are moving. The result is more precise and sensitive X-rays. Zhou's invention led to a start-up company, Xintek.

Other examples of commercialization leading to spin-offs include therapeutic agents for Parkinson's Disease, technologies for drug delivery to treat cancer, industrial applications for carbon nanotubes, and gene therapy treatment for diseases like muscular dystrophy.

Carolina North: Tapping the Full Potential

The University's future contributions to the North Carolina economy one day will include Carolina North, to be built on 900 acres of UNC-owned land less than two miles from main campus.

Carolina North will redefine the University's engagement with the state, nation, and world. University leaders intend to create a vibrant, innovative setting for outreach and service, research collaborations with private industry and public agencies, and economic development for North Carolina.

The University advanced its conceptual plan for Carolina North in the past year. A new economic impact study projects that completion of the first two phases of Carolina North by 2020 will create over 7,500 permanent high-wage jobs for North Carolinians. That means \$433 million in annual salary and personal

income and \$600 million in annual business revenue. Construction will create 9,000 jobs, \$353 million in personal income, and \$979 million in business revenue. Carolina North should generate \$48 million in recurring tax revenue.

The study confirmed that Carolina North has the potential to position the University as a leading national center for public-private partnerships and to be a catalyst for the state's economic transformation.

A separate three-year Horace Williams Airport site study by an aviation engineering and consulting firm examined possible alternate airport sites to accommodate Medical Air Operations (MedAir). That work included an analysis of the costs of moving MedAir to Raleigh-Durham International Airport to enable development of Carolina North.

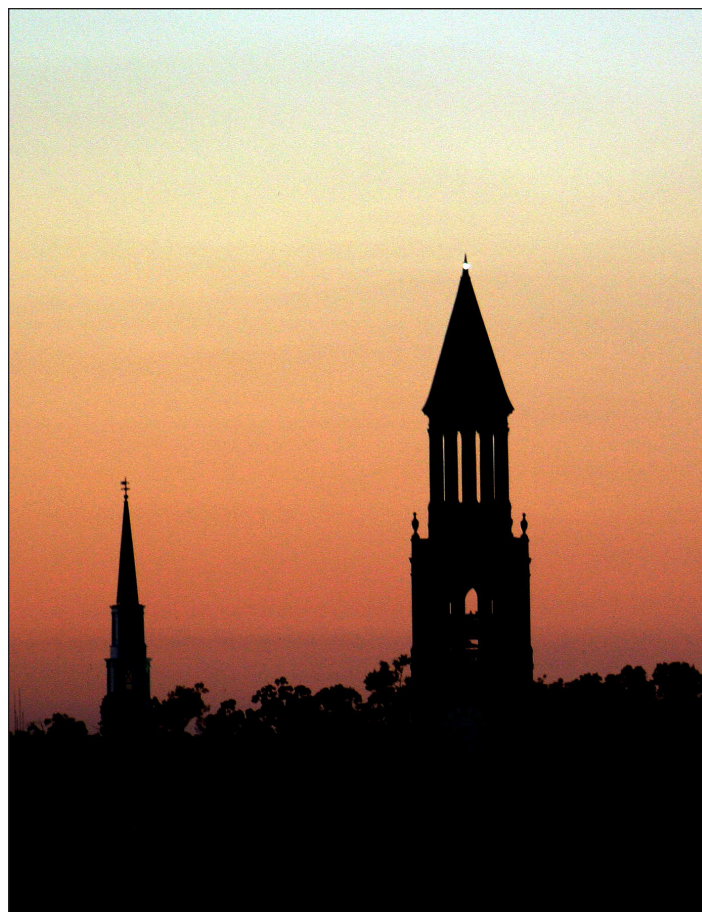
In addition, during its meeting on May 26, 2005, the Board of Trustees unanimously endorsed the University's vision for Carolina North.

Academic Reputation: Highlighting Rankings and Leadership

Several national publications and reports ranked Carolina prominently during fiscal 2005 in categories ranging from academic quality to affordability to diversity to entrepreneurship to international presence.

Highlights included the following:

- 5th best public university in *U.S. News & World Report's* 2006 "Best Colleges" guidebook. Affirmation as a national leader in student accessibility; 1st among public campuses and 10th overall in "Great Schools, Great Prices," based on academic quality, net cost of attendance and average student debt. 5th among publics for "least debt." 54% of course sections enrolled fewer than 20 students — a key UNC measure of excellence.
- Kenan-Flagler Business School: tied for 5th among undergraduate programs; tied for second among public campuses.
- 4th among public universities in "*The Top American Research Universities*," produced in December 2004 by the Lombardi Program on Measuring University Performance at the University of Florida. Based on categories such as research, endowment assets, private giving, faculty, and advanced training.
- 1st among the 100 best public colleges combining great academics and affordable tuitions as ranked by *Kiplinger's Personal Finance*. Carolina has been first four consecutive times.
- A "best value" among 81 schools chosen for "*America's Best Value Colleges, 2006 Edition*" by *The Princeton Review/Random House* for outstanding academics, relatively low costs, and generous financial aid packages. Carolina has appeared in this publication two years in a row.
- 1st for the top entrepreneurial campus and 5th "most connected," according to *The Princeton Review* and *Forbes.com*. UNC has an undergraduate business degree offering with a concentration in entrepreneurship in the Kenan-Flagler Business School, a new minor in entrepreneurship in the College of Arts and Sciences, and a new Carolina Entrepreneurial Initiative. In 2000, UNC became the nation's largest university requiring undergraduates to own laptop computers. With more than 850 wireless access points, UNC provides wireless connectivity in classrooms, labs, libraries, residence halls, and quadrangles.
- 1st among public research universities, for the second consecutive year, recording the highest rate of undergraduates studying abroad in 2002-2003; 7th among all research universities for the total number of undergraduates going abroad, according to an annual report published by the Institute of International Education.
- 1st among U.S. academic institutions recognized as "best places to work for postdocs," according to *The Scientist* magazine. Based on conditions for postdoctoral fellows working



PICTURESQUE SUNSET The sun sets over the campus, creating a dark outline of the Bell Tower.

in the life sciences as part of the magazine's third annual survey. Carolina was 6th among all U.S. institutions, including government institutions and private research centers.

- "Hottest" for health careers, according to the *Kaplan/Newsweek 2005 "How to Get into College"* guide, based on admissions trends and interviews with a broad array of educators, admissions officers, students and other longtime observers of the admissions process. An article in the guide says UNC's diverse offerings in the health disciplines — all in the same place — are helping attract prospective students.
- 14th — the highest ranking for any major public research university — in the 2004 *"Black Enterprise-DayStar Top 50 Colleges and Universities for African Americans"* list. This ranking was based on responses to questions about which schools were both a good academic and social fit for African-Americans.

SCHOLAR Right: Rachel Mazyck of Laurel, Md., a 2002 Carolina graduate, won a 2005 Rhodes Scholarship to Oxford University in England. She became the 38th winner from Carolina since 1902. UNC ranks second among U.S. public universities in numbers of Rhodes Scholars produced. 2005 was one of the university's most successful years ever for undergraduates awarded prestigious national and international scholarships.



- One of the nation's top universities in fostering social responsibility and public service, according to *The Princeton Review* and *Campus Compact*. Carolina appears in a book, *"Colleges With a Conscience: 81 Great Schools With Outstanding Community Involvement."* Based on admissions practices, scholarships rewarding community service, and support for service-learning programs.
- Among the 20 very "best buy" public universities in the U.S. and Canada as judged by the 2005 Fiske Guide to Colleges based on the quality of the academic programs in relation to the cost of attendance.
- Degree programs or specialty areas from the schools of business, education, law, medicine, pharmacy, public health as well as the College of Arts and Sciences appeared prominently in the Spring 2005 edition of *U.S. News & World Report's "American's Best Graduate Schools"* issue. Highlights included medicine, overall primary care, 2nd, overall research, tied for 23rd; pharmacy, 3rd for Pharm.D. doctoral program; Kenan-Flagler Business School's MBA program, tied for 21st, law, tied for 27th; education, tied for 27th; sociology, tied for 4th; history, tied for 13th; political science, tied for 13th; English, tied for 19th; and psychology, tied for 22nd.
- Kenan-Flagler Business School appeared in several other recent best MBA program lists. They included *Business Week*, 16th; *Forbes*, 14th; *The Wall Street Journal*, 9th based on a survey of corporate recruiters; *The Financial Times*, 7th; and *Hispanic Business*, 5th, among top business schools for Hispanics. The school's international executive education program was ranked 17th overall by *The Financial Times*. The school was included in a new *Princeton Review* book, *"Best 143 Business Schools,"* and the MBA program was ranked 6th for best campus environment, 10th for best professors and 10th for most family friendly.

MBA PROGRAM *Business Week* magazine ranked UNC Kenan-Flagler's Executive MBA Program fifth. UNC graduates were surveyed and gave high marks for teaching quality by a top-notch faculty, the team-based environment, and a responsive staff.

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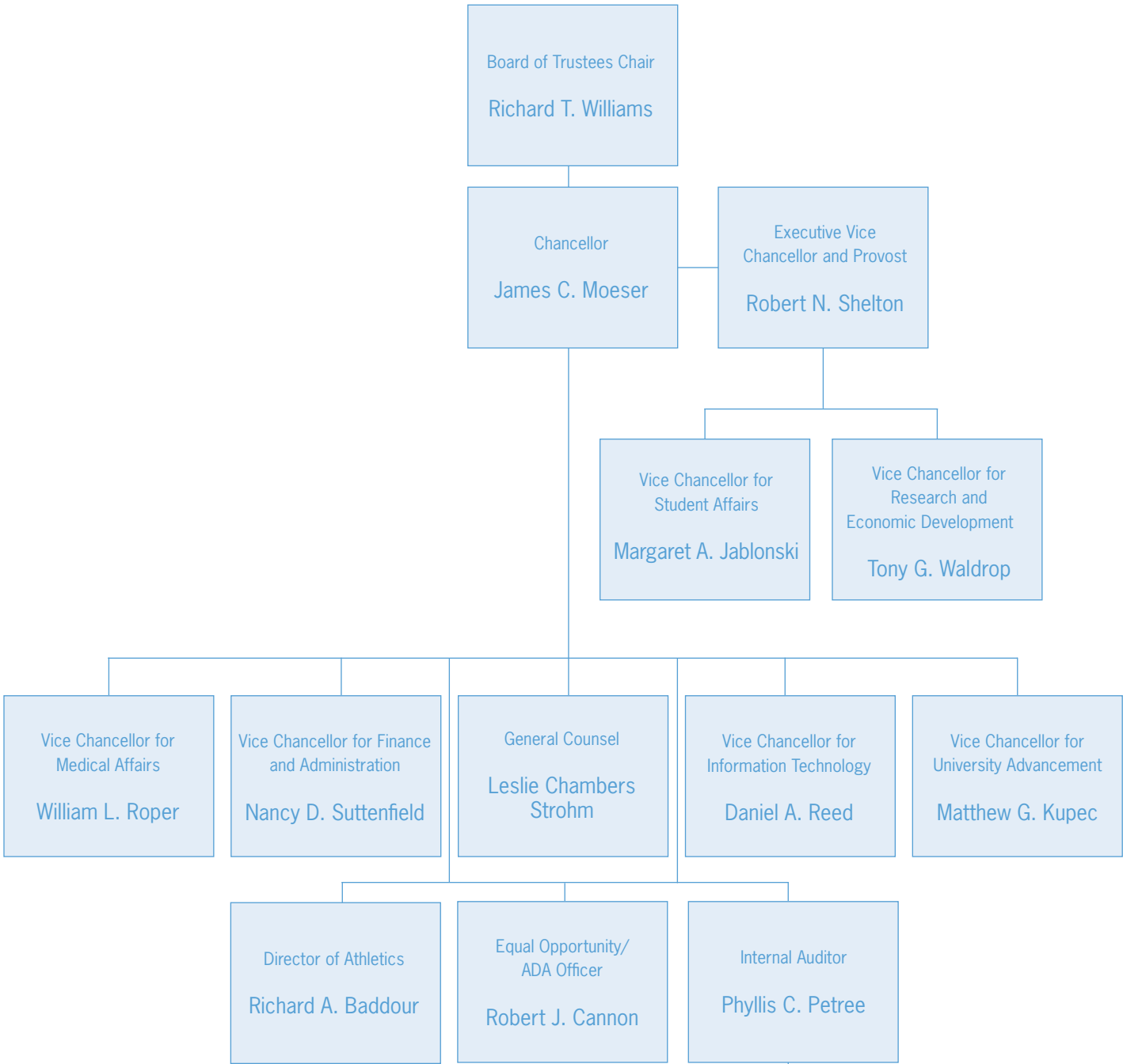
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The University of North Carolina at Chapel Hill
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FINANCIAL SECTION

Students enjoy a lecture on the quad at the south end of McCorkle Place.



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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
 The University of North Carolina at Chapel Hill
 Chapel Hill, North Carolina

We have audited the accompanying financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2005, which collectively comprise The University of North Carolina at Chapel Hill's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of North Carolina at Chapel Hill and its discretely presented component units,

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

as of June 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*, during the year ended June 30, 2005.

In accordance with *Government Auditing Standards*, we will also issue our report dated November 30, 2005 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. The report on internal control and compliance will be issued under separate cover in the Financial Statement Audit Report of The University of North Carolina at Chapel Hill published by this Office.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The introductory and statistical sections, identified in the table of contents, were not audited by us, and accordingly, we do not express an opinion thereon.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

November 30, 2005

MANAGEMENT’S DISCUSSION AND ANALYSIS

Introduction

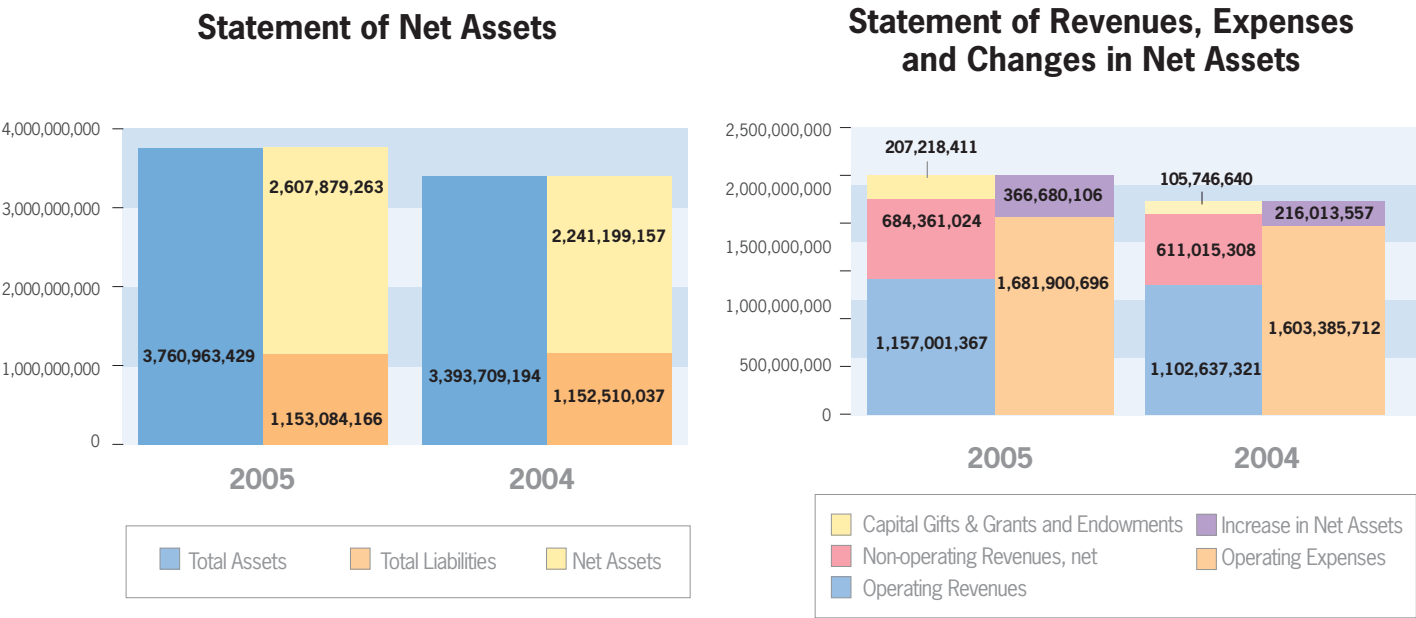
Management’s discussion and analysis provides an overview of the financial position and activities of The University of North Carolina at Chapel Hill (the “University”) for the fiscal year ended June 30, 2005, with comparative information for the fiscal year ended June 30, 2004. Management has prepared the discussion and analysis to be read in conjunction with the financial statements and accompanying note disclosures.

The University is a constituent institution of the 16-campus University of North Carolina System (UNC System), a component unit of the State of North Carolina and an integral part of the state’s *Comprehensive Annual Financial Report*. The financial reporting entity for the financial statements is comprised of the University and 10 component units. Although legally separate, The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc., UNC Investment Fund, LLC, UNC Management Company, Inc., The University of North Carolina at Chapel Hill Foundation, Inc., The Kenan-Flagler Business School Foundation, The School of Social Work Foundation, Inc., and U.N.C. Law Foundation, Inc. are reported as if they were part of the University. The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. are legally separate, non-profit, tax-exempt organizations that are reported as discretely presented component units based on the nature and significance of their relationship to the University.

Management’s discussion and analysis includes a separate section regarding the three component units that are discretely reported in the financial statements. The remainder of the management’s discussion and analysis pertains to the University and the seven component units reported as part of the University.

Financial Highlights

The University’s financial position at June 30, 2005 remained strong with total assets of \$3.8 billion. Net assets, which represent the residual interest in the University’s assets after deducting liabilities, were \$2.6 billion at June 30, 2005. The University’s net assets increased by \$367 million in fiscal year 2004–2005, when operating, non-operating, and other changes are included. A comparison of the total assets, liabilities, and net assets at June 30, 2005 and 2004 and a comparison of the major components of the changes in net assets for the two fiscal years is presented below:



Net assets increased 16.4 percent at June 30, 2005 over the prior year. Total assets increased 10.8 percent and total liabilities increased less than one percent for the same period. Operating revenues increased at the same rate as operating expenses in 2004–2005 over the prior year, 4.9 percent. Net non-operating revenues and expenses increased 12 percent in 2004–2005 over the prior year. The state appropriations growth of 6.9 percent was significant, given the previous, lesser rates of increase. Investment income growth remained strong with a 14.4 percent increase in 2004–2005

over the prior year. Research funding, fund raising for operational and capital needs, and construction funding through the North Carolina Higher Education Bond Referendum of 2000 continued to be positive factors in the improved financial well-being of the University.

Using the Financial Statements

The financial statements have been prepared in accordance with Governmental Accounting Standards Board (GASB) principles. Beginning with the fiscal year ended June 30, 2002, the financial statements have been based on the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities*. The full scope of the University’s activities is considered to be a single business-type activity and accordingly, is reported within a single column in the basic financial statements.

Effective for the fiscal year ended June 30, 2005, the University implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. The statement provides disclosures that inform readers about deposit and investment risks that could impact the entity’s ability to provide services and meet its financial obligation. Among the issues addressed are common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, custodial credit risk, and foreign currency risk.

The University’s Comprehensive Annual Financial Report includes the following three financial statements.

- Statement of Net Assets
- Statement of Revenues, Expenses, and Changes in Net Assets
- Statement of Cash Flows

Management’s discussion and analysis provides information regarding each of these financial statements.

Other important characteristics of the financial statements include the following:

- Net assets represent the excess of total assets over total liabilities. There are three classes of net assets – unrestricted, restricted (non-expendable and expendable), and invested in capital assets net of related debt.
- Assets and liabilities are categorized as either current or non-current. Current liabilities are due within one year, and current assets are those assets available to pay current liabilities.
- Revenues and expenses are categorized as either operating or non-operating, and a net income or loss from operations is displayed. State appropriations, noncapital gifts and grants, and investment income are non-operating revenues, which results in a net loss from operations.
- Tuition and fees revenues are reported net of scholarships and

fellowships that are applied to student accounts. The “scholarship discounts” reduce the tuition and fees revenues and the scholarship and fellowship expenses by equal amounts. Scholarships and fellowships paid directly to students continue to be reported as expenses.

- Expenses are reported in the financial statements by natural classification such as salaries and benefits, supplies and materials, and other categories. Presentation by program classification such as instruction, research, and public service are disclosed in the notes to the financial statements.
- Purchases of capital assets are expensed over the asset’s useful life by the recognition of depreciation expense on the capital assets.
- A Statement of Cash Flows using the direct method is reported.

Condensed Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year, includes all assets and liabilities of the University, and segregates the assets and liabilities into current and non-current components. Net assets represent the difference between total assets and total liabilities and are one indicator of the University’s current financial condition. The following table summarizes the University’s assets, liabilities, and net assets at June 30, 2005 and 2004.

Assets, Liabilities, and Net Assets

| | 2005 | 2004 as Restated | % Change |
|---|------------------------|------------------------|-------------|
| Assets: | | | |
| Current assets | \$856,015,143 | \$810,667,402 | 5.6 |
| Non-current assets: | | | |
| Endowment investments | 972,461,495 | 848,469,859 | 14.6 |
| Other long-term investments | 283,640,904 | 299,874,517 | (5.4) |
| Capital assets, net | 1,550,201,138 | 1,276,669,341 | 21.4 |
| Other non-current assets | 98,644,749 | 158,028,075 | (37.6) |
| Total Assets | 3,760,963,429 | 3,393,709,194 | 10.8 |
| Liabilities: | | | |
| Current liabilities | 420,350,366 | 401,819,861 | 4.6 |
| Non-current liabilities: | | | |
| Funds held in trust for pool participants | 260,960,010 | 235,608,859 | 10.8 |
| Long-term liabilities | 440,422,863 | 482,557,455 | (8.7) |
| Other non-current liabilities | 31,350,927 | 32,523,862 | (3.6) |
| Total Liabilities | 1,153,084,166 | 1,152,510,037 | 0.0 |
| Net Assets: | | | |
| Invested in capital assets, net of related debt | 1,017,382,707 | 855,739,608 | 18.9 |
| Restricted: | | | |
| Non-expendable | 378,234,148 | 328,735,341 | 15.1 |
| Expendable | 736,631,596 | 648,019,434 | 13.7 |
| Unrestricted | 475,630,812 | 408,704,774 | 16.4 |
| Total Net Assets | \$2,607,879,263 | \$2,241,199,157 | 16.4 |

CURRENT ASSETS AND LIABILITIES

The Statement of Net Assets shows the University had total assets of \$3.8 billion at June 30, 2005, an increase of 10.8 percent over the prior year. Working capital, which is current assets less current liabilities, was \$435.7 million at June 30, 2005, an increase of 6.6 percent over the previous year. One significant factor causing the working capital improvement was the increase in short-term investments resulting from increased expendable resources and investment returns.

Current assets are represented graphically below:

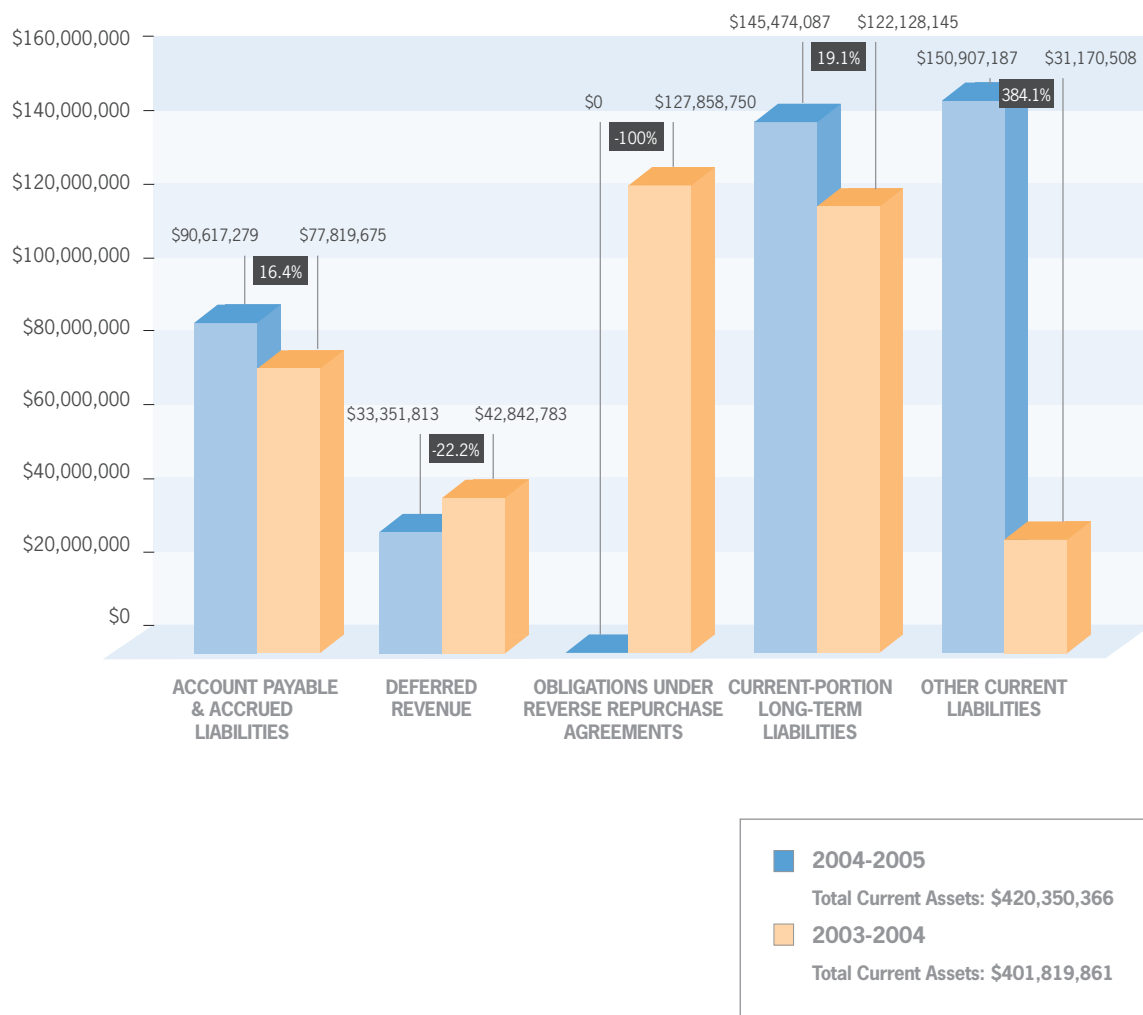
Current Assets - Comparative



- Cash and cash equivalents include cash in bank accounts, cash with fiscal agents, and cash invested through the State Treasurer of North Carolina.
- Short-term investments include funds invested through an investment pool administered by the University.
- Receivables include amounts due from students of the University, patients of the professional health-care clinics, governmental and private entities for contract and grant awards, donors for pledges of gifts, as well as accrued investment earnings.
- Inventories represent goods for resale by auxiliary operations of the University.
- Other current assets include student loans and amounts due from the State of North Carolina or its component units.

Current liabilities are represented graphically below:

Current Liabilities - Comparative



- Accounts payable and accrued liabilities include payables to vendors, accrued payroll costs, and retainage on construction contracts.
- Deferred revenue is primarily gifts through the planned giving program and represents the calculated remainder after annuity obligations to beneficiaries are determined based on the terms of the gift annuity, charitable trust, or other planned giving arrangement.
- Obligations under reverse repurchase agreements are liabilities incurred as part of the University's investment management program.
- The current portion of long-term liabilities includes bonds payable, notes payable, capital leases payable, annuity payable, and compensated absences (accrued vacation leave).
- Other current liabilities include amounts due to the State of North Carolina or its component units, deposits and interest payable, funds held for others, and short term debt.

ENDOWMENT AND OTHER LONG-TERM INVESTMENTS

Endowment investments increased 14.6 percent during 2004–2005 and were \$972.5 million at June 30, 2005 and \$848.5 million at June 30, 2004, and include permanent endowments, funds internally designated as endowments and similar funds such as gift annuities and charitable trusts. Net assets of endowment and similar funds were \$930.6 million at June 30, 2005 and \$801.3 million for the prior year.

The endowment assets are invested with The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (the “Investment Fund”), which is reported as a governmental external investment pool in the financial statements. The Investment Fund is a 501(c)(3) non-profit corporation established to support the University by operating an investment pool for charitable, non-profit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University.

Effective January 1, 2003, the assets of the Investment Fund were contributed and assigned to the UNC Investment Fund, LLC (“System Fund”), a North Carolina limited liability company organized and operated to invest member’s assets contributed and assigned to it from time to time by the Investment Fund and by The University of North Carolina and its constituent institutions and their related endowments and tax-exempt foundations. All or substantially all of the assets of the Investment Fund are expected to be invested in the System Fund. Separate, audited financial statements for the Investment Fund and System Fund are available. Refer to Note 1A to obtain the separate financial statements. The investment returns noted below refer to the pooled investment fund in existence for that time period.

The net assets of the endowment are categorized as restricted non-expendable, restricted expendable, or unrestricted.

- Restricted non-expendable net assets include permanent endowments for which the donor has stipulated that the principal shall remain inviolate and be invested in perpetuity to generate earnings that can be expended consistent with the purposes specified in the gift instrument.
- Restricted expendable net assets include internally designated endowments established by the University with restricted gifts and the undistributed earnings of permanent endowments.
- Unrestricted net assets include internally designated endowments established by the University with unrestricted funds.

The investment objective is to earn an average real total return of at least 5.5 percent per year, net of all fees, over rolling five- and ten-year periods. The earnings distribution policy is to provide a stable source of spending support that is sustainable over the long term while preserving the purchasing power of the endowment. The earnings distribution rate was established at 5 percent of the previous year’s market value, with annual increases based on inflationary factors. Each year’s distribution is subject to a 4 percent floor and a 7 percent cap based on estimated fiscal year-end market value.

Other long-term investments of \$283.6 million at June 30, 2005 include funds of \$246.2 million of affiliated entities that are not part of the University’s financial reporting entity but do invest through the System Fund, and bond reserves and related funds of \$37.4 million.

Most of the University’s endowment assets are managed within the System Fund, a pooled investment fund vehicle. The System Fund is designed to provide long-term, stable rates of return on the invested assets through the use of a highly diversified portfolio strategy. The nominal return on the endowment assets invested in the System Fund for fiscal year 2004–2005 was 15.5 percent, with a real return of 13 percent after inflation. The respective returns for fiscal year 2003–2004 were 16 percent and 12.8 percent. The System Fund return of 15.5 percent for 2004–2005 exceeded the Strategic Investment Policy Portfolio (“SIPP”) return of 13.8 percent by 1.7 percent. The System Fund’s return also exceeded the 70 percent S&P 500 / 30 percent Lehman Brothers Bond Index (“70/30”) return of 6.6 percent for the year.

The strong investment performance of the past two years has increased the three-year compound return to 11.5 percent at June 30, 2005. This three-year return measure compares well with the corresponding measure of 10.3 percent for the SIPP and 7.8 percent for the 70/30. The System Fund is very well positioned in the current environment and remains invested according to the approved investment policy that provides excellent diversification in both bull and bear markets.

CAPITAL ASSETS AND DEBT MANAGEMENT

A critical aspect for enhancing and maintaining the University’s academic, research, and service programs and its residential life is the development and renewal of its capital assets. The University Board of Trustees approved the campus master plan to guide the University’s physical development in the 21st Century. The master plan meshes the critical pieces needed for smart growth in the 21st Century – transportation, parking, housing, utilities, and environmental sustainability – with the program needs of a growing campus. The master plan combines the practical requirements of a research university with the beauty that inspired its founders. The University will grow dramatically in the coming years.

A summary of changes in capital assets is disclosed in Note 5. Capital assets, net of accumulated depreciation, at June 30, 2005 and June 30, 2004 were as follows:

| | 2005 | 2004 | % Change |
|--------------------------|------------------------|------------------------|-------------|
| Construction in progress | \$377,522,418 | \$219,339,291 | 72.1 |
| Land and other | | | |
| non-depreciable assets | 86,347,452 | 85,103,216 | 1.5 |
| Buildings | 798,180,554 | 703,546,321 | 13.5 |
| General infrastructure | 202,593,509 | 187,589,810 | 8.0 |
| Machinery and equipment | 85,557,205 | 81,090,703 | 5.5 |
| Total | <u>\$1,550,201,138</u> | <u>\$1,276,669,341</u> | 21.4 |

The University is engaged in a \$1.5 billion capital construction program that began in 2000 and will continue through the next four years. This program includes major capital renewal of existing buildings and infrastructure to address both deferred maintenance and programmatic needs.

Major projects completed in fiscal year 2004–2005 include the Rams Head Center, the Michael Hooker Research Center for the School of Public Health, the addition to and renovation of Memorial Hall, the Carrington Hall addition for the School of Nursing, the Health Sciences Library renovation, and the Kenan, McIver, and Alderman residence halls renovations. The Rams Head Center combines a major new facility for student life with a new 700-car parking deck. It includes a retail grocery store, new dining facility with six different venues, new student recreation center with three court gymnasium, elevated running track, exercise room, and cardiofitness center. The buildings constructed on top of the parking deck form a new open space and pedestrian bridges which connect this facility to student residences to the south and north campus. The new open space incorporates a sophisticated stormwater management system to capture and reuse stormwater as irrigation for the landscape. The Michael Hooker Research Center, the addition to the School of Public Health, provides new research laboratories and office space, lecture hall and seminar rooms, and a new atrium to provide much-needed gathering space for the School of Public Health.

Memorial Hall was originally constructed in 1931 and is used extensively for student assemblies and performances, lectures, concerts, and traveling theatrical productions. The project provided air-conditioning and a larger stage with wing space, as well as modernized stage equipment and production needs. The Carrington Hall addition provides teaching laboratories, faculty offices and lecture hall for the School of Nursing. The new addition also features a rooftop garden which incorporates a stormwater management system to capture and reuse stormwater as irrigation for the garden. This addition will be the first LEED (Leadership in Energy and Environmental Design) certified building at Carolina.

The renovation of the Health Sciences Library provided a comprehensive renovation to this 1960's facility including new mechanical, electrical, and telecommunications systems. New compact storage on the ground floor allowed for the addition of group study space and a new café. The renovations to the Kenan, McIver, and Alderman residence halls provided a comprehensive renovation including new heating and cooling systems, telecommunication wiring, and new elevators. The buildings are now completely accessible and the living rooms have been restored.

Major projects under construction at June 30, 2005 include Phase I of the Carolina Physical Science Complex, Student Family Housing, Phase II of the Residence College capital program, the Medical Sciences Research Building addition and renovation, and renovations to Burnett Womack Building. Major infrastructure improvements continue as part of the master plan for capital development.

Research facilities are a critical component of the construction

program, and fiscal year 2004–2005 brought substantial improvements to the physical infrastructure supporting research. Several key research facilities were renovated, including the entire Health Sciences Library, the 11th floor of Mary Ellen Jones Building, the School of Dentistry Building, and the historic 440 West Franklin Street building. Renovations were begun in Brauer Hall, Burnett Womack, and the Medical Research Building. The School of Nursing addition and the new School of Public Health's Hooker Center are fully occupied, equipped and contributing to our research capacity.

The Science Complex will replace outdated, deteriorating buildings with state-of-the-art facilities. It will provide an innovative learning atmosphere for students and open doors for integrated collaboration among Carolina's scientists. The complex will house the University's departments of chemistry, computer science, marine sciences, mathematics, physics, and astronomy, and a new Institute for Advanced Materials, Nanoscience and Technology. The Science Complex Phase 1 is under way and both Phase II and III are projected to bid this year.

The 36 completed projects total \$310 million, or 21 percent of the \$1.5 billion capital construction program. The 42 projects under construction total \$750 million or 50 percent, and the 64 projects under design represent \$440 million or 29 percent. Capital funds resulting from North Carolina Higher Education Bonds continue to provide essential resources for construction. The University is directly investing in its capital construction program using a variety of other funding sources including University bonds, cost reimbursements from research grants, internal reserves, and private gifts. Previous changes in state legislation allowed the University to pledge a broader stream of revenues as security for its debt obligations, and general revenue bonds are issued to finance capital construction. The general revenue pledge results in a stronger, more flexible security that captures the strengths of not only the University's auxiliary and student-related revenues, but also its research programs.

In December 2003, the University issued \$108 million in fixed-rate bonds to finance certain capital construction projects. The University continues to use its commercial paper program that provides low-cost bridge financing for capital projects until gifts are received or in anticipation of an external bond issue. Commercial paper debt was \$141.1 million at June 30, 2005 and \$8.8 million at June 30, 2004. The commercial paper program and the general revenue bonds allow the University to use a central bank concept for funding capital projects. The University issues fixed and variable rate debt externally, and blends the average borrowing rate to allocate debt costs to individual capital projects and campus divisions. This concept provides a stable and flexible debt-funding source for capital projects.

The University maintains a combination of variable and fixed rate debt, consistent with its debt management policy. The effective, combined interest rate for variable and fixed rate debt was 4.5 percent for fiscal year 2004–2005 and 4.36 percent for 2003–2004. The interest rate on the commercial paper program for fiscal year 2004–2005 was 1.82 percent and for 2003–2004 was 0.98 percent.

Interest rates on the University's variable rate, long-term bonds were 1.82 percent for fiscal year 2004-2005 and one percent for 2003-2004. Interest rates on fixed rate, long-term bonds are disclosed in Note 8B of the financial statements. The University's financial strength allowed it to achieve ratings of AA+/Aa1 by the national rating agencies. The University debt service to operations ratio, a measure of an entity's dependence on borrowed funds, was only 2.2 percent at June 30, 2005 and 2.1 percent for the prior year.

OTHER NON-CURRENT ASSETS

Other non-current assets were \$98.6 million at June 30, 2005 and \$158 million at June 30, 2004, a 37.6 percent decrease. Included in this category at June 30, 2005 are restricted cash and cash equivalents of \$3.9 million, receivables for pledged gifts of \$30.3 million, notes receivable for student loans of \$29 million, restricted resources due from the primary government of \$27.1 million, and an investment in a joint venture of \$8.3 million.

The decrease in other non-current assets from the prior year resulted primarily from a \$67 million decline in cash and cash equivalents. The decline resulted from the expenditure of note proceeds invested as a cash equivalent for the Student Family Housing construction project and the discontinued use of reverse repurchase agreements which are sales of securities with a simultaneous agreement for repurchase.

Restricted resources due from the primary government represent receivables for designated capital construction projects funded from proceeds from statewide higher education bonds and other state resources. The investment in a joint venture represents the construction of the Southern Astrophysical Research Telescope (SOAR), situated in Cerro Pachon, Chile, in South America, as part of an international consortium including the University.

NON-CURRENT LIABILITIES

Non-current liabilities were \$732.7 million at June 30, 2005 and \$750.7 million at June 30, 2004 and include funds held in trust for the University's affiliated foundations and other campuses in the UNC System and their affiliates of \$261 million and \$235.6 million respectively. These entities are not part of the University's financial reporting entity but do invest through the System Fund. The increase in funds held in trust of 10.8 percent over the prior year resulted from strong investment performance and participant contributions.

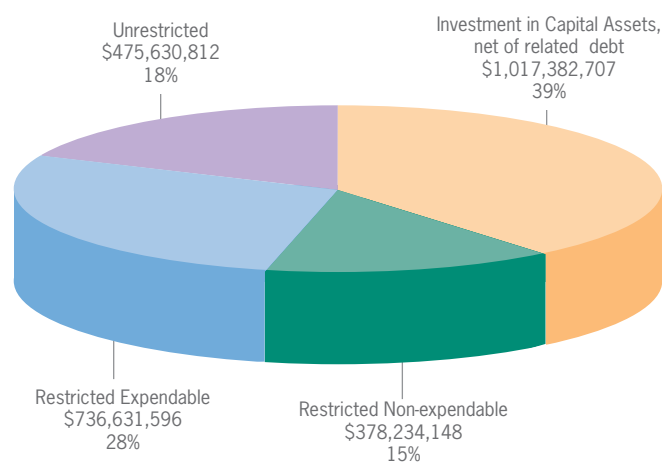
Long-term liabilities of \$440.4 million at June 30, 2005 and \$482.6 million at June 30, 2004 are the non-current portion

of bonds payable, notes payable, capital leases payable, compensated absences, and annuities payable. The decrease of 8.7 percent from the prior year resulted from principal payments on bonds. The reader may refer to Note 8 for summary of changes in long-term liabilities. Other non-current liabilities of \$31.4 million at June 30, 2005 and \$32.5 million at June 30, 2004 are refundable U.S. government grants that provide resources for student loan programs.

NET ASSETS

Net assets represent the value of the University's assets after liabilities are deducted. The University's net assets were \$2.6 billion at June 30, 2005, an increase of \$367 million over the prior year.

2005 NET ASSETS: \$2,607,879,263



The invested in capital assets, net of related debt category represents the University's land, buildings, general infrastructure, equipment, and other capital assets net of accumulated depreciation and net of the outstanding bonds and other indebtedness on the facilities. The restricted non-expendable category includes the University's permanent endowments funds. The restricted expendable category primarily includes restricted internally designated endowments, gifts, contract and grant awards, and distributed endowment earnings. The unrestricted category includes unrestricted internally designated endowments, gifts, auxiliary operations, facilities and administrative funds (overhead receipts), and other unrestricted funds. While there are no externally imposed restrictions on unrestricted funds, the funds are generally designated by the University for specific academic programs or capital needs.

Condensed Statement of Revenues, Expenses, and Changes in Net Assets

The Statements of Revenues, Expenses, and Changes in Net Assets present the University's results of operations. The statements for the fiscal year ended June 30, 2005 and the prior year are summarized as follows:

University Operations

| | 2005 | 2004 | % Change |
|--|------------------------|------------------------|-------------|
| Operating Revenues: | | | |
| Student tuition and fees, net | \$164,456,925 | \$153,943,215 | 6.8 |
| Grants and contracts | 524,476,342 | 499,798,678 | 4.9 |
| Sales and services, net | 462,459,945 | 443,227,663 | 4.3 |
| Other | 5,608,155 | 5,667,765 | (1.1) |
| Total Operating Revenues | <u>1,157,001,367</u> | <u>1,102,637,321</u> | 4.9 |
| Operating Expenses: | | | |
| Salaries and benefits | 966,629,252 | 917,840,235 | 5.3 |
| Supplies and materials | 148,439,992 | 151,196,308 | (1.8) |
| Services | 407,689,396 | 380,125,640 | 7.3 |
| Scholarships and fellowships | 51,169,976 | 47,427,018 | 7.9 |
| Utilities | 47,870,170 | 46,207,389 | 3.6 |
| Depreciation | 60,101,910 | 60,589,122 | (0.8) |
| Total Operating Expenses | <u>1,681,900,696</u> | <u>1,603,385,712</u> | 4.9 |
| Operating Loss | (524,899,329) | (500,748,391) | 4.8 |
| Non-operating Revenues (Expenses): | | | |
| State appropriations | 406,672,962 | 380,446,327 | 6.9 |
| Non-capital grants | 62,544,341 | 53,153,741 | 17.7 |
| Non-capital gifts, net | 73,692,797 | 68,517,192 | 7.6 |
| Investment income, net | 154,899,571 | 135,369,198 | 14.4 |
| Interest and fees on capital asset-related debt | (21,822,928) | (18,339,114) | 19.0 |
| Other non-operating revenues (expenses) | <u>8,374,281</u> | <u>(8,132,036)</u> | 203.0 |
| Income Before Other Changes | 159,461,695 | 110,266,917 | 44.6 |
| Capital grants | 152,844,246 | 74,392,000 | 105.5 |
| Capital appropriations | 5,165,922 | 897,387 | 475.7 |
| Capital gifts | 11,520,297 | 6,358,879 | 81.2 |
| Additions to permanent endowments | <u>37,687,946</u> | <u>24,098,374</u> | 56.4 |
| Increase in Net Assets | 366,680,106 | 216,013,557 | 69.7 |
| Net Assets – July 1 | <u>2,241,199,157</u> | <u>2,025,185,600</u> | 10.7 |
| Net Assets – June 30 | <u>\$2,607,879,263</u> | <u>\$2,241,199,157</u> | 16.4 |

Fiscal year 2004–2005 revenues and other changes and expenses total \$2,070,403,730 and \$1,703,723,624, respectively. Fiscal year 2003–2004 revenues and other changes and expenses total \$1,845,870,419 and \$1,629,856,862, respectively.

OPERATING REVENUES

The operating revenues represent resources generated by the University in fulfilling its instruction, research, and public service missions. Student tuition and fees are reported net of the scholarship discount, which was \$37.9 million for fiscal year 2004–2005 and \$33.3 million for the prior year. Total revenues from student tuition and fees increased 6.8 percent over the prior year. The 2004–2005 tuition rates increased 8.5 percent for undergraduate residents, 10.1 percent for undergraduate non-residents, 7.9 percent for graduate residents, and 9.9 percent for graduate non-residents. There were also limited tuition increases for the professional schools. The revenue growth from the rate increases was offset by a shift in residency status among graduate students from non-resident to resident.

Revenues from grants and contracts increased 4.9 percent over the prior year as reflected in the financial statements. Discussion of grants and contracts in terms of awards provides another useful perspective. The University is among the nation’s leading public research universities, with a diversified portfolio of research that attracted more than \$579 million in sponsored program awards during fiscal year 2004–2005, a 0.3 percent increase over the previous year. During the same period, awards from the Department of Health and Human Services increased more than 4 percent to \$338 million. During the federal fiscal year 2003–2004 (the latest available numbers), University faculty attracted \$289.7 million in National Institutes of Health (NIH) awards, up from \$271 million in 2003, ranking 15th overall among U.S. private and public universities. The University is the top public university in the South and one of only six Southern universities, public or private, cited in the NIH’s top 20. All five of the University’s health affairs schools – dentistry, medicine, nursing, pharmacy and public health – ranked within the top 20 of public and private institutions, according to the NIH. The University continues to rank in the top 20 educational institutions nationally in federal support for science and technology.

The NIH Roadmap committee and office established by the Office of the Vice Chancellor for Research and Economic Development, has been instrumental in supporting a number of new research initiatives that are geared toward new funding opportunities at NIH. Last year, Carolina researchers received three of the 21 P-20 NIH Roadmap Awards offered nationally. The Citizen-Soldier Support Program coordinated by the University was initially funded through a \$1.8 million Congressional award. The program facilitates practical and emotional support for North Carolina National Guard and Reserve soldiers and their families preparing for, during and after return from deployments. This initiative gives communities more ways to support military men and women and their families and shows that Carolina and

its program partners connect with the citizens of this state and their needs.

Sales and services and patient services revenues of \$462.5 million for fiscal year 2004–2005 represent an increase of 4.3 percent over the prior year and include the revenues of campus auxiliary operations such as student housing, student stores, student health services, the utilities system, and parking and transportation, as well as revenues from patient services provided by the professional health-care clinics. Net revenues generated by the health-care clinics decreased 0.5 percent in 2004–2005. Although gross revenues from patient services net of the allowance for uncollectible accounts increased by 4.2 percent, the \$17.7 million increase in indigent care and contractual adjustments caused the slight decrease in net revenues from patient services. Other revenues of \$5.6 million for fiscal year 2004–2005 represent operating resources not separately identified and include, as examples, an assessment to the Investment Fund to support administrative services, library fines, and interest income from student loans.

OPERATING EXPENSES

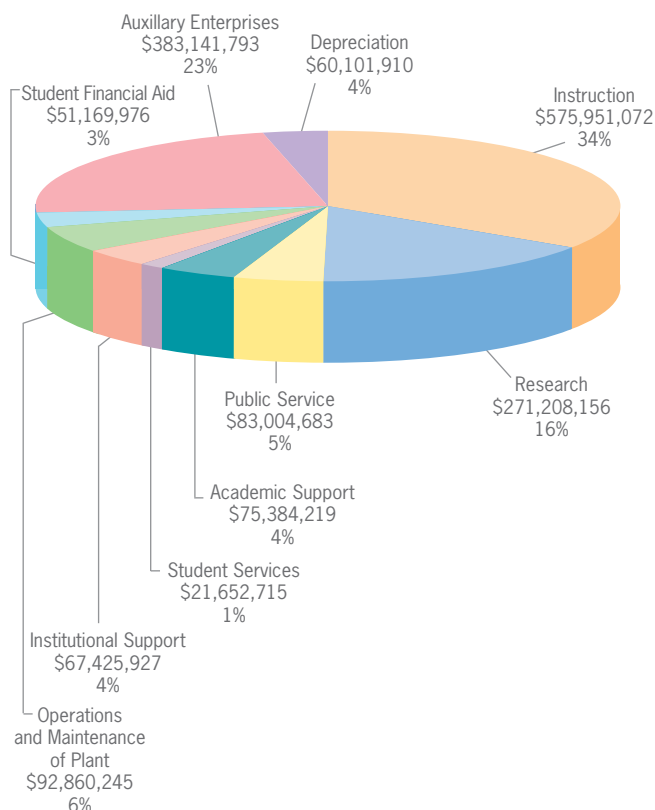
The University’s operating expenses were \$1.7 billion for the fiscal year ended June 30, 2005, an increase of 4.9 percent over the prior year. The operating expenses are reported by natural classification in the financial statements and by functional classification in the note disclosures (Note 11). The following table illustrates the University’s operating expenses by the functional classification:

Operating Expenses by Function

| | 2005 | 2004 | % Change |
|--|------------------------|------------------------|-------------|
| Instruction | \$575,951,072 | \$532,927,326 | 8.1 |
| Research | 271,208,156 | 257,945,228 | 5.1 |
| Public Service | 83,004,683 | 78,275,601 | 6.0 |
| Academic Support | 75,384,219 | 75,692,980 | (0.4) |
| Student Services | 21,652,715 | 20,487,890 | 5.7 |
| Institutional Support | 67,425,927 | 64,731,371 | 4.2 |
| Operations and Maintenance of Plant | 92,860,245 | 87,890,864 | 5.7 |
| Student Financial Aid | 51,169,976 | 47,427,018 | 7.9 |
| Auxiliary Enterprises | 383,141,793 | 377,418,312 | 1.5 |
| Depreciation | 60,101,910 | 60,589,122 | (0.8) |
| Total Operating Expenses | <u>\$1,681,900,696</u> | <u>\$1,603,385,712</u> | 4.9 |

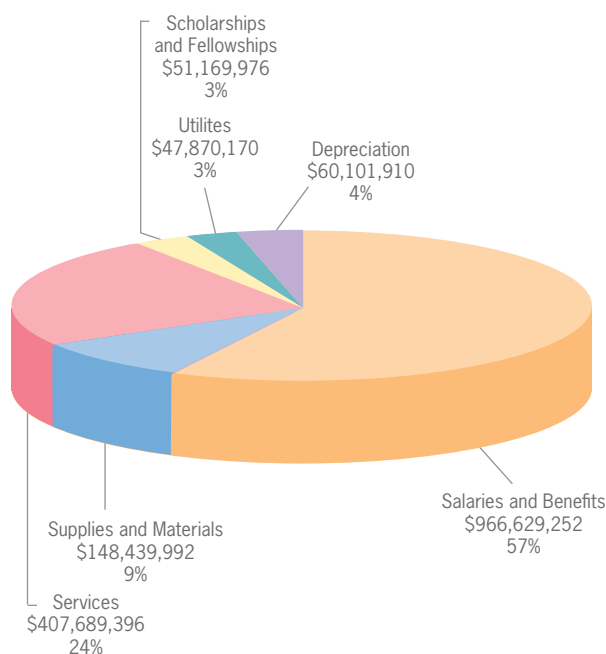
The following graph illustrates the University’s operating expenses by function.

2005 OPERATING EXPENSES BY FUNCTION: \$1,681,900,696



The following graph illustrates the University's operating expenses by the natural classification.

2005 OPERATING EXPENSES BY NATURE: \$1,681,900,696



Operating expense categories reported by natural classification generally increased or decreased at a comparable rate to total operating expenses. Salaries and benefits increased 5.3 percent in 2004-2005 over the prior year, expenses for services increased 7.3 percent, scholarships and fellowships increased 7.9 percent, and utilities increased 3.6 percent. Supplies and materials decreased 1.8 percent, and depreciation decreased 0.8 percent.

NON-OPERATING REVENUES AND EXPENSES

State appropriations of \$406.7 million, noncapital grants of \$62.5 million, non-capital gifts of \$73.7 million, investment income of \$154.9 million, interest and fees on capital asset-related debt of (\$21.8) million, and other revenues and expenses of \$8.4 million comprise net non-operating revenues and expenses. These revenues are considered non-operating because they were not generated by the University's principal, ongoing operations. For example, state appropriations were not generated by the University but were provided to help fund operating expenses.

The University's initial budget for state appropriations was \$400.7 million for fiscal year 2004-2005. Budget increases of \$17.5 million included funding of \$10.4 million for salary and benefit increases for faculty and staff, \$4.6 million for increased student enrollment including distance learning and other program enhancements, and \$2.5 million for other initiatives. Budget reductions in state appropriations were \$11.5 million. Included in the budget reductions was a \$1.1 million decrease based on legislation which exempted the University from paying sales and use taxes which resulted in lowering operating expenses by a like amount. A budget reduction of \$2.9 million was required in response to storm damage suffered throughout the state in August and September of 2004 resulting from hurricanes. The resulting appropriations of \$406.7 million represented a 6.9 percent increase over fiscal year 2003-2004. The University uses an annual budget planning and hearing process with all deans and vice chancellors. The review process provides a framework to implement differential budget reductions.

Non-capital grants increased by 17.7 percent to \$62.5 million in fiscal year 2004-2005 and represent federal awards that are not considered to be operating revenues. Net non-capital gifts increased by 7.6 percent to \$73.7 million and represent expendable gifts received and pledges made and are net of an allowance for uncollectible pledges. Net investment income of \$154.9 million, an increase of 14.4 percent over 2003-2004, includes income and realized and unrealized gains and is net of realized and unrealized losses and investment management fees. For detail discussion, the reader may refer to Endowment and Other Long-term Investments section of Management's Discussion and Analysis. Interest and fees on capital asset-related debt were (\$21.8) million, an increase of 19 percent over the prior year.

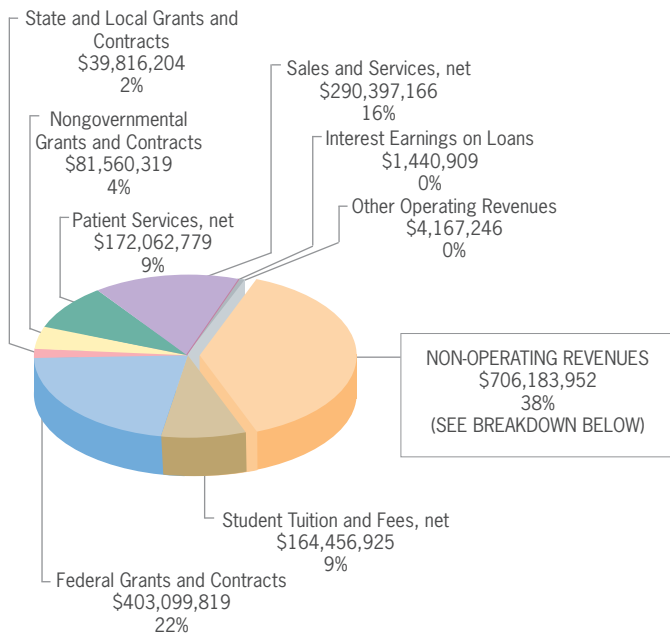
Other non-operating revenues and expenses were \$8.4 million and include a \$6.6 million increase in the net assets of annuities and charitable remainder trusts. These annuities and charitable remainder trusts include split-interest agreements that have a liability component for the present value of projected future distributions to the annuitant or donor and liabilities to other organizations where

the University reporting entity serves as trustee but not the beneficiary of the split-interest agreements. Changes in the actuarial calculations of the liabilities will increase or decrease the net assets of the annuities and charitable remainder trusts. The increase in fiscal year 2004–2005 over the prior year resulted in part from net asset increases in these annuities and trust.

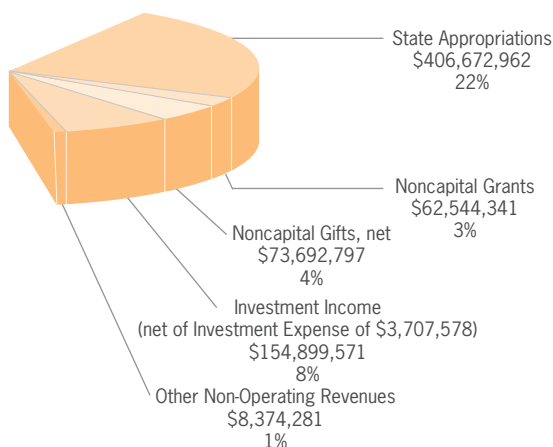
TOTAL OPERATING AND NON-OPERATING REVENUES

Operating and non-operating revenues such as state appropriations, noncapital grants, noncapital gifts, and investment income are used to fund University operations. The following chart illustrates the University's operating and non-operating revenues which total \$1.9 billion for fiscal year 2004–2005.

2005 TOTAL REVENUES BY SOURCE: \$1,863,185,319



NON-OPERATING REVENUES



OTHER CHANGES IN NET ASSETS

Capital grants of \$152.8 million for 2004–2005 and \$74.4 million for 2003–2004 are from statewide higher education bond proceeds for capital construction projects. Capital appropriations of \$5.2 million for 2004–2005 and \$0.9 million for the prior year were received from the state for repairs and replacements. Net capital gifts of \$11.5 million for 2004–2005 and \$6.4 million for the prior year resulted from fund-raising efforts and also provided funding for construction projects. Non-expendable gifts and funds from the state's program to match gifts for distinguished professorship endowments resulted in additions to permanent endowments of \$37.7 million during fiscal year 2004–2005 and \$24.1 million during fiscal year 2003–2004.

Condensed Statement of Cash Flows

The Statement of Cash Flows provides additional information about the University's financial results by reporting the major sources and uses of cash. Cash decreased by \$85.3 million during the fiscal year 2004–2005, compared with an increase of \$46.9 million during fiscal year 2003–2004. The primary factor which caused the decrease in the cash position at June 30, 2005 was the decreased use of the State Treasurer's short-term investment fund (STIF), which is classified as a cash equivalent, for the University's temporary investment pool. The temporary investment pool's investment in STIF was \$120 million at June 30, 2004 and zero at June 30, 2005. The statements for the fiscal year ended June 30, 2005 and the prior year are summarized as follows:

Cash Flows

| | 2005 | 2004 as Restated | % Change |
|------------------------------------|----------------------|----------------------|-------------|
| Cash Flows Provided (Used): | | | |
| Operating activities | (\$460,045,805) | (\$348,742,031) | 31.9 |
| Noncapital | | | |
| financing activities | 589,302,508 | 325,768,875 | 80.9 |
| Capital and related | | | |
| financing activities | (67,227,484) | (107,595,259) | (37.5) |
| Investing activities | (147,354,384) | 177,517,901 | (183.0) |
| Net Increase (Decrease) | | | |
| in Cash | (85,325,165) | 46,949,486 | (281.7) |
| Cash – July 1 | 544,687,966 | 497,738,480 | 9.4 |
| Cash – June 30 | <u>\$459,362,801</u> | <u>\$544,687,966</u> | (15.7) |

- Cash flows from operating activities include, as examples, cash received for tuition and fees or research grants and salaries paid to faculty or payments of invoices to vendors. Since state appropriations, gifts, and certain other revenues are not considered operating revenue, operating activities had a net cash outflow for both fiscal years.
- Noncapital financing activities include state appropriations received for operations and noncapital gifts, and had a net cash inflow for both fiscal years.

- The cash flows from capital and related financing activities include the proceeds received from short-term and long-term debt obligations, the repayment of debt, and the acquisition and construction of capital assets.
- The net cash outflows from investing activities include purchases and sales of equity securities and other investments as well as interest and dividends received. The significant change in the cash flows from investing activities resulted from additional investment purchases due to increased levels of gifts and other funds available for investment.

Component Units Reported Using Discrete Presentation

Potential component units of the University, primarily the affiliated fund-raising foundations, are evaluated to determine if the financial statements of the potential component unit should be:

- combined with those of the University in the Comprehensive Annual Financial Report (CAFR),
- reported separately (i.e., discretely) along with the University's financial statements in the CAFR, or
- not reported in the CAFR.

Three affiliated foundations were categorized as component units using discrete presentation. Discrete presentation provides readers with complete information regarding the financial activities of the components units. The reader may refer to Notes 1A for additional information regarding the three affiliated foundations.

Summary information regarding the financial activities of the three affiliated foundations follows:

Total Net Assets

| | 2005 | 2004 | % Change |
|--------------------------------|----------------------|----------------------|-------------|
| Assets and Liabilities: | | | |
| Total assets | \$431,586,835 | \$389,576,735 | 10.8 |
| Total liabilities | 2,165,737 | 2,387,485 | (9.3) |
| Total net assets | \$429,421,098 | \$387,189,250 | 10.9 |
| Net Assets Composition: | | | |
| Unrestricted | \$20,653,221 | \$17,723,823 | 16.5 |
| Temporarily restricted | 238,744,849 | 209,029,695 | 14.2 |
| Permanently restricted | 170,023,028 | 160,435,732 | 6.0 |
| Total net assets | \$429,421,098 | \$387,189,250 | 10.9 |

Unrestricted net assets are expendable and do not have external restrictions regarding use of the resources, temporarily restricted net assets are expendable but are subject to restrictions regarding allowable uses and the timing for availability, and permanently restricted net assets are not expendable and the related earnings are subject to restrictions regarding allowable uses.

Changes in Net Assets

| | 2005 | 2004 | % Change |
|------------------------|----------------------|----------------------|-------------|
| Total revenues | \$75,805,739 | \$73,909,097 | 2.6 |
| Total expenses | 33,573,891 | 25,359,735 | 32.4 |
| Increase in net assets | 42,231,848 | 48,549,362 | (13.0) |
| Net assets – July 1 | 387,189,250 | 338,639,888 | 14.3 |
| Net assets – June 30 | <u>\$429,421,098</u> | <u>\$387,189,250</u> | 10.9 |

The 32.4 percent increase in expenses resulted primarily from additional grants to the University.

Economic Outlook

The University's financial position and outlook are favorable. The University is well positioned to continue demonstrating excellence in teaching, discovery, and public service. Management believes that fiscal year 2004–2005 demonstrated an improvement on a solid financial foundation. The University's strong debt credit rating allows it to obtain competitive financing for capital construction. The University's comparatively low tuition levels enhance its appeal to prospective students and provide a possible source of additional resources, should tuition increases be enacted.

Tuition rates increased for fiscal year 2005–2006 by 4.3 percent for undergraduate non-residents, 5.9 percent for graduate residents, and 5.7 percent for graduate non-residents. There was no tuition rate increase for undergraduate residents. There were limited tuition increases for the professional schools. The University's academic standing allows it to continuously attract top students. Student application levels, enrollment levels of students including cross admits, applicants' exam scores, and other admission criteria, and other factors illustrate the substantial appeal of the University to prospective students. The University's ratio of accepted applications as a percentage of total applications was 35.8 percent for 2004–2005. The ratio of enrolled students as a percentage of accepted applications was 53.2 percent for 2004–2005. Carolina's tuition levels remain low compared with its national peer group of institutions.

The Carolina Covenant provides qualified students from low-income families with a Carolina education debt-free. Carolina Covenant Scholars agree to work on campus 10 to 12 hours weekly in a federal work-study job, and the University meets the rest of their needs through a combination of federal, state, University, and other privately funded grants and scholarships. Effective with the fall semester of 2005, the Carolina Covenant is expanding the program to include families with incomes up to 200 percent of the federal poverty level. This move will cover a family of four with an annual income of about \$37,000 or a single parent with a child who makes about \$24,000. These changes strengthen an already solid message about accessibility and the traditional commitment to opportunity in Chapel Hill for qualified students, regardless of their ability to pay.

The University's relationship with the State of North Carolina is an important success factor. The governor and the General Assembly have continued to demonstrate strong financial support for higher education in North Carolina. The budgeted funding level for state appropriations for 2005–2006 totals \$439.2 million, which represents an increase of 8 percent over fiscal year 2004–2005 actual state appropriations. This level of state appropriation funding includes faculty and staff pay and benefit increases of \$12.2 million. The fiscal year 2005–2006 pay increase of the greater of 2 percent or \$850 is the second consecutive year of base salary increases for all employees. Other budget increases included \$8.9 million for student enrollment increases, \$10.9 million for planned operating expenses for new construction, and \$5.9 million for the Renaissance Computing Institute based in Chapel Hill and created in partnership with Duke and North Carolina State universities. The 2005–2006 appropriations budget also included a base budget reduction of \$6.3 million. While additional budget reductions or reversions are not anticipated for fiscal year 2005–2006, it is not certain.

The University must continue to address competitive pressures related to recruiting and retaining faculty and staff. The University continues aggressive efforts to address competitive pressures on faculty and staff salaries and benefits. In particular, University staff continues to support UNC System efforts to provide an improved health insurance program for faculty and staff. In addition, the University is moving forward with a plan to develop below-market housing for faculty and staff. The University's diverse revenue base, its strategic planning processes, and its proactive approach in addressing budgetary issues help alleviate the significance of the impacts.

A central factor in supporting research is our ability to recover facilities and administrative (F&A) costs associated with sponsored research. This year, two innovations helped to ensure that the University recovered our fair share of F&A. First, new space-survey software was developed to more accurately identify the space used for research in campus facilities. Second, a year-long study of library use was conducted to more fully understand and document how the library organization supports research. The library user survey has solidified the library component of the proposed rate that objectively recognizes the library organization's value to the research enterprise and will sustain overhead funding for library support to Carolina research at a competitive level compared to our public peers. These investments, efforts and initiatives are paying off as an unprecedented F&A recovery rate for Carolina has been proposed to the federal government. The University still has the federal review and negotiation process to go through, but is beginning that phase in a stronger position than ever before.

Carolina's research enterprise creates jobs for the state's economy. Expenditures resulting from research funding at UNC-Chapel Hill cycle through the state and local economies, transforming federal funds into revenue for North Carolina residents and businesses. Using a U.S. government multiplier of 1.7, Carolina's \$579.6 million in research funding generated approximately \$985 million in economic impact. The University continues its commitment to transfer new technologies developed by our faculty to the marketplace. Planning continued for Carolina North, an approximately 1,000-acre tract of land that will support the research, teaching, and public service mission of the University. A master plan for Carolina North was developed and presented to the broad community in an extensive series of meetings. Based upon feedback at these

meetings, a revised plan was developed and endorsed by the Board of Trustees. The site approvals for the first two buildings, an incubator building and the Frank Porter Graham Child Development First School, were approved by the Board of Trustees.

Management believes the investment performance of its endowment fund will continue to earn attractive returns and provide important resources for University operations. The University's investment management operation is separately organized as the UNC Management Company, Inc., a non-profit corporation organized and operated as a 501(c)(3) entity, to provide investment management services and administrative services to the University and to the other campuses of the UNC System and their affiliated non-profit foundations as appropriate. Management believes this structure will continue to enhance the ability to attract and retain investment professionals and increase the pool of funds and resulting investment returns.

The University's fund-raising efforts on behalf of the University and its affiliated foundations continue to achieve a high level of success, and provide critical resources for the present and for future generations. Initially announced on October 11, 2002, the \$1.8 billion Carolina First Campaign began its quiet phase on July 1, 1999. The campaign's volunteer leaders increased its goal to \$2 billion in October 2005.

As of June 30, 2005, gifts, pledges and deferred commitments of \$1.5 billion had been recorded. Cash and other assets received represent 69 percent of the \$1.5 billion paid or pledged. Of the \$1.8 billion original goal, over half is targeted directly for the University and for the business school, social work, law, and UNC-Chapel Hill foundations, with the remainder for the other University-affiliated

foundations. As of June 30, 2005, endowment commitments totaled \$611 million toward the overall endowment goal of \$700 million. With 75 percent of the campaign period elapsed, the fund-raising drive has reached 87 percent of the endowment goal. The campaign will conclude on June 30, 2007, and management anticipates the goal will be attained. For the eighth time in the past 12 years, a national organization that supports educational advancement efforts has honored the University for its fund-raising success. Carolina received a 2005 CASE/ID Wealth Award for Educational Fund Raising for its overall performance from the Council for Advancement and Support of Education, which works with educational institutions to enhance their alumni-relations, communications, and development efforts.

The University's priorities are to strengthen faculty recruitment, retention, and development; create the richest possible learning environment for undergraduate, graduate, and professional students; invest in centers of excellence in research and creativity; enhance Carolina's engagement with North Carolina and the world; successfully complete the campus development plan and begin Carolina North; determine strategies to direct resources to highest priorities; and define Carolina's role as a leader.

Increased support from the state, the ability to attract top prospective students, vibrant research funding, continued strength in investment performance, a dynamic capital construction program, and an exceptional fund-raising campaign all contribute to a positive outlook for the University. The University's commitment to sound financial and budgetary planning, protection and enhancement of its endowed and physical assets, and observance of compliance and control standards support a solid financial future for the University.

STATEMENT OF NET ASSETS

June 30, 2005

Assets

Current Assets:

| | |
|--|--------------------|
| Cash and cash equivalents | \$167,582,741 |
| Restricted cash and cash equivalents | 287,909,706 |
| Short-term investments | 168,610,555 |
| Restricted short-term investments | 94,133,344 |
| Receivables, net (Note 4) | 113,924,440 |
| Due from State of North Carolina component units | 2,767,663 |
| Inventories | 17,400,526 |
| Notes receivable, net (Note 4) | 3,686,168 |
| Total current assets | <u>856,015,143</u> |

Non-current Assets:

| | |
|---|-----------------------------|
| Restricted cash and cash equivalents | 3,870,354 |
| Receivables, net (Note 4) | 30,321,103 |
| Restricted due from primary government | 27,089,076 |
| Endowment investments | 972,461,495 |
| Other long-term investments | 283,640,904 |
| Notes receivable, net (Note 4) | 29,045,299 |
| Investment in joint venture | 8,318,917 |
| Capital assets, non-depreciable (Note 5) | 463,869,870 |
| Capital assets, depreciable, net (Note 5) | 1,086,331,268 |
| Total non-current assets | <u>2,904,948,286</u> |
| Total assets | <u>3,760,963,429</u> |

Liabilities

Current Liabilities:

| | |
|---|--------------------|
| Accounts payable and accrued liabilities (Note 6) | 90,617,279 |
| Due to primary government | 212,802 |
| Due to State of North Carolina component units | 1,409,355 |
| Deposits payable | 1,919,543 |
| Funds held for others | 3,694,809 |
| Deferred revenue | 33,351,813 |
| Interest payable | 2,529,678 |
| Short-term debt (Note 7) | 141,141,000 |
| Long-term liabilities - current portion (Note 8) | 145,474,087 |
| Total current liabilities | <u>420,350,366</u> |

Non-current Liabilities:

| | |
|---|-----------------------------|
| U. S. government grants refundable | 31,350,927 |
| Funds held in trust for pool participants | 260,960,010 |
| Long-term liabilities (Note 8) | 440,422,863 |
| Total non-current liabilities | <u>732,733,800</u> |
| Total liabilities | <u>1,153,084,166</u> |

| | |
|--------------------------------------|-------------------------------|
| Total assets less liabilities | <u>\$2,607,879,263</u> |
|--------------------------------------|-------------------------------|

The accompanying notes to the financial statements are an integral part of this statement.

STATEMENT OF NET ASSETS (CONTINUED)

June 30, 2005

Net Assets

| | |
|---|-------------------------------|
| Invested in capital assets, net of related debt | <u>\$1,017,382,707</u> |
| Restricted for: | |
| Non-expendable: | |
| Scholarships and fellowships | 85,350,731 |
| Research | 14,625,341 |
| Library acquisitions | 23,096,771 |
| Professorships and lectureships | 155,460,576 |
| Departmental uses | 55,337,122 |
| Loans | 14,362,032 |
| Other | <u>30,001,575</u> |
| Total restricted non-expendable | <u>378,234,148</u> |
| Expendable: | |
| Scholarships and fellowships | 145,256,120 |
| Research | 16,752,163 |
| Library acquisitions | 37,905,662 |
| Professorships and lectureships | 233,532,312 |
| Departmental uses | 250,999,091 |
| Instruction and educational agreements | 12,930,841 |
| Plant improvements | 14,409,834 |
| Capital projects | 15,913,073 |
| Debt service | <u>8,932,500</u> |
| Total restricted expendable | <u>736,631,596</u> |
| Unrestricted | <u>475,630,812</u> |
| Total net assets | <u>\$2,607,879,263</u> |

The accompanying notes to the financial statements are an integral part of this statement.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

For the Fiscal Year Ended June 30, 2005

Revenues

Operating Revenues:

| | |
|---|----------------------|
| Student tuition and fees, net (Note 10) | \$164,456,925 |
| Patient services, net (Note 10) | 172,062,779 |
| Federal grants and contracts | 403,099,819 |
| State and local grants and contracts | 39,816,204 |
| Non-governmental grants and contracts | 81,560,319 |
| Sales and services, net (Note 10) | 290,397,166 |
| Interest earnings on loans | 1,440,909 |
| Other operating revenues | <u>4,167,246</u> |
| Total operating revenues | <u>1,157,001,367</u> |

Expenses

Operating Expenses:

| | |
|------------------------------|----------------------|
| Salaries and benefits | 966,629,252 |
| Supplies and materials | 148,439,992 |
| Services | 407,689,396 |
| Scholarships and fellowships | 51,169,976 |
| Utilities | 47,870,170 |
| Depreciation | <u>60,101,910</u> |
| Total operating expenses | <u>1,681,900,696</u> |
| Operating loss | <u>(524,899,329)</u> |

Non-Operating Revenues (Expenses):

| | |
|--|--------------------|
| State appropriations | 406,672,962 |
| Non-capital grants | 62,544,341 |
| Non-capital gifts, net (Note 10) | 73,692,797 |
| Investment income (net of investment expense of \$3,707,578) | 154,899,571 |
| Interest and fees on capital asset related debt | (21,822,928) |
| Other non-operating revenues | <u>8,374,281</u> |
| Net non-operating revenues | <u>684,361,024</u> |
| Income before other revenues | 159,461,695 |
| Capital appropriations | 5,165,922 |
| Capital grants | 152,844,246 |
| Capital gifts | 11,520,297 |
| Additions to endowments | <u>37,687,946</u> |
| Increase in net assets | 366,680,106 |

Net Assets

| | |
|-----------------------------------|-------------------------------|
| Net assets - July 1, 2004 | <u>2,241,199,157</u> |
| Net assets - June 30, 2005 | <u>\$2,607,879,263</u> |

The accompanying notes to the financial statements are an integral part of this statement.

STATEMENT OF CASH FLOWS

For the Fiscal Year Ended June 30, 2005

Cash Flows from Operating Activities

| | |
|---|----------------------|
| Received from customers | \$1,151,504,503 |
| Payments to employees and fringe benefits | (966,176,894) |
| Payments to vendors and suppliers | (600,239,677) |
| Payments for scholarships and fellowships | (51,169,976) |
| Loans issued to students | (6,482,788) |
| Collection of loans to students | 9,059,245 |
| Other receipts | <u>3,459,782</u> |
| Net cash used by operating activities | <u>(460,045,805)</u> |

Cash Flows from Non-capital Financing Activities

| | |
|---|--------------------|
| State appropriations | 406,672,962 |
| Non-capital grants received | 67,026,288 |
| Non-capital gifts received | 62,930,161 |
| Additions to permanent endowments | 37,687,946 |
| Related activity agency receipts | <u>14,985,151</u> |
| Net cash provided by non-capital financing activities | <u>589,302,508</u> |

Cash Flows from Capital and Related Financing Activities

| | |
|---|---------------------|
| Proceeds from capital debt | 150,729,724 |
| Capital grant | 146,901,291 |
| Capital appropriations | 5,165,922 |
| Capital gifts | 10,958,365 |
| Acquisition and construction of capital assets | (318,730,947) |
| Principal paid on capital debt and leases | (39,607,649) |
| Interest and fees paid on capital debt and leases | <u>(22,644,190)</u> |
| Net cash used by capital and related financing activities | <u>(67,227,484)</u> |

Cash Flows From Investing Activities

| | |
|---|-----------------------------|
| Proceeds from sales and maturities of investments | 935,151,022 |
| Investment income | 32,698,725 |
| Purchase of investments and related fees | (987,345,381) |
| Change in obligations under reverse repurchase agreements | <u>(127,858,750)</u> |
| Net cash used by investing activities | <u>(147,354,384)</u> |
| Net decrease in cash and cash equivalents | (85,325,165) |
| Cash and cash equivalents, July 1 | <u>544,687,966</u> |
| Cash and cash equivalents, June 30 | <u>\$459,362,801</u> |

The accompanying notes to the financial statements are an integral part of this statement.

STATEMENT OF CASH FLOWS (CONTINUED)

For the Fiscal Year Ended June 30, 2005

Reconciliation of net operating revenues (expenses) to net cash used by operating activities:

| | |
|--|-------------------------------|
| Operating loss | (\$524,899,329) |
| Adjustments to reconcile operating loss to net cash used by operating activities: | |
| Depreciation expense | 60,101,910 |
| Provision for uncollectible loans and writeoffs | (754,326) |
| Changes in assets and liabilities: | |
| Receivables, net | (1,305,275) |
| Inventories | (1,812,269) |
| Notes receivable, net | 1,055,097 |
| Accounts payable and accrued liabilities | 7,528,586 |
| Due to primary government | 120,834 |
| U.S. government grants refundable | (1,172,935) |
| Deferred revenue | 2,317,786 |
| Compensated absences | (1,225,884) |
| Net cash used by operating activities | <u>(\$460,045,805)</u> |

Non-cash investing, capital, and financing activities:

| | |
|---|--------------|
| Assets acquired through assumption of a liability | \$784,763 |
| Assets acquired through a gift | \$561,932 |
| Change in fair value of investments | \$66,797,060 |

Reconciliation of cash and cash equivalent:

| | |
|---|-----------------------------|
| Current Assets: | |
| Cash and cash equivalents | \$167,582,741 |
| Restricted cash and cash equivalents | 287,909,706 |
| Non-current assets: | |
| Restricted cash and cash equivalents | 3,870,354 |
| Total cash and cash equivalent - June 30, 2005 | <u>\$459,362,801</u> |

The accompanying notes to the financial statements are an integral part of this statement.

COMPONENT UNITS

STATEMENT OF FINANCIAL POSITION

June 30, 2005

| | ARTS AND SCIENCES FOUNDATION, INC. | THE EDUCATIONAL FOUNDATION SCHOLARSHIP ENDOWMENT TRUST | THE MEDICAL FOUNDATION OF NORTH CAROLINA, INC. |
|---|---|---|---|
| Assets: | | | |
| Current Assets | | | |
| Cash and cash equivalents | \$8,297,311 | \$7,734,230 | \$33,745,072 |
| Investments | | 119,406,517 | 91,477,285 |
| Unconditional promises to give | 5,628,109 | 7,581,475 | 2,413,671 |
| Contributions receivable | | | |
| from split interest agreements | | 3,332,944 | |
| Accounts receivable | 135,602 | | |
| Funds held in trust | 188,446 | | |
| Accrued income receivable | 21,822 | | 200,100 |
| Prepaid expenses | | | 12,707 |
| Miscellaneous receivables | | | 177,267 |
| Total current assets | 14,271,290 | 138,055,166 | 128,026,102 |
| Property and equipment | | | |
| Building | | | 436,340 |
| Furniture and equipment | 88,464 | | 341,016 |
| | 88,464 | | 777,356 |
| Less: allowance for depreciation | (66,940) | | (411,543) |
| Total property and equipment | 21,524 | | 365,813 |
| Other Assets: | | | |
| Investments | 79,972,005 | | 42,970,980 |
| Unconditional promises to give, net | 11,354,784 | | 10,688,891 |
| Restricted cash | 2,766,272 | | 231,725 |
| Escrow deposit | 200,000 | | |
| Restricted investments | | | 259,133 |
| Real estate interests held for investment | 49,500 | | |
| Student loans receivable | | | 39,095 |
| Cash surrender value of life insurance | | 1,956,360 | 358,195 |
| Total other assets | 94,342,561 | 1,956,360 | 54,548,019 |
| Total assets | \$108,635,375 | \$140,011,526 | \$182,939,934 |
| Liabilities and Net Assets: | | | |
| Current liabilities | | | |
| Accounts payable | \$8,745 | | \$204,214 |
| Annuities payable | | \$202,736 | |
| Accrued expenses | 123,922 | | 1,123,329 |
| Deferred revenue | | | 240,000 |
| Total current liabilities | 132,667 | 202,736 | 1,567,543 |
| Long-term debt | 262,791 | | |
| Total liabilities | 395,458 | 202,736 | 1,567,543 |
| Net assets | | | |
| Unrestricted | 10,093,745 | | 10,559,476 |
| Temporarily restricted | 46,906,276 | 63,996,638 | 127,841,935 |
| Permanently restricted | 51,239,896 | 75,812,152 | 42,970,980 |
| Total net assets | 108,239,917 | 139,808,790 | 181,372,391 |
| Total liabilities and net assets | \$108,635,375 | \$140,011,526 | \$182,939,934 |

The accompanying notes to the financial statements are an integral part of this statement.

COMPONENT UNITS

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

For the Fiscal Year ended June 30, 2005

| | ARTS AND SCIENCES FOUNDATION, INC. | THE EDUCATIONAL FOUNDATION SCHOLARSHIP ENDOWMENT TRUST | THE MEDICAL FOUNDATION OF NORTH CAROLINA, INC. |
|---|---|---|---|
| Support and Revenue: | | | |
| Support | | | |
| Contributions | \$7,809,276 | \$6,793,061 | \$15,369,525 |
| Development assessment fee | 1,183,082 | | |
| Donated facilities | 40,000 | | |
| Actuarial adjustment of annuities payable | | 3,936 | |
| Endowment investment return designated for current operations | | 5,400,697 | |
| Total support | 9,032,358 | 12,197,694 | 15,369,525 |
| Revenue | | | |
| Interest and dividend income | | | 3,860,562 |
| Net unrealized and realized gains (losses) on investments | 8,989,292 | | 12,633,447 |
| Investment income | 2,464,674 | | |
| Loss on sale of real estate investments | | | (34,910) |
| Gain on sale of property and equipment | | | 9,404 |
| Other income | | | 554,120 |
| Total revenue | 11,453,966 | | 17,022,623 |
| Total support and revenue | 20,486,324 | 12,197,694 | 32,392,148 |
| Expenses: | | | |
| Program services | | | |
| Grants | 9,123,219 | | 14,033,976 |
| Scholarship expense distribution | | 5,391,034 | |
| Annuity payments | | 9,663 | |
| Administrative expenses | | 56,471 | |
| Other expenses | | 632,819 | |
| Total program services | 9,123,219 | 6,089,987 | 14,033,976 |
| Supporting services | | | |
| Fund-raising expenses | 1,659,748 | | 1,000,319 |
| Management and general | 681,946 | | 984,696 |
| Total supporting services | 2,341,694 | | 1,985,015 |
| Total expenses | 11,464,913 | 6,089,987 | 16,018,991 |
| Change in net assets from operations | 9,021,411 | 6,107,707 | 16,373,157 |
| Other changes: | | | |
| Investment return in excess of amounts designated for current operations | | 10,729,573 | |
| Changes in net assets | 9,021,411 | 16,837,280 | 16,373,157 |
| Net assets - beginning of year | 99,218,506 | 122,971,510 | 164,999,234 |
| Net assets - end of year | \$108,239,917 | \$139,808,790 | \$181,372,391 |

The accompanying notes to the financial statements are an integral part of this statement.

NOTES TO THE FINANCIAL STATEMENTS

June 30, 2005

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Note 1: Significant Accounting Policies

A. Financial Reporting Entity – The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The University of North Carolina at Chapel Hill (University) is a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component units are either blended or discretely presented in the University's financial statements. The blended component units, although legally separate, are, in substance, part of the University's operations and therefore, are reported as if they were part of the University. Discretely presented component units' financial data are reported in separate financial statements because of their use of different GAAP reporting models and to emphasize their legal separateness.

Blended Component Units – Although legally separate, The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (Investment Fund), UNC Investment Fund, LLC (System Fund), UNC Management Company, Inc. (Management Company), The University of North Carolina at Chapel Hill Foundation, Inc. (UNC-Chapel Hill Foundation), The Kenan-Flagler Business School Foundation (Business School Foundation), The School of Social Work Foundation Inc. (Social Work Foundation), and U.N.C. Law Foundation Inc. (Law Foundation), are reported as if they were part of the University.

The Investment Fund is governed by a board consisting of 11 ex-officio directors and one or two elected directors. Ex-officio directors include all of the members of the Board of Trustees of the Endowment Fund of the University, the vice chancellor for finance and administration, and the vice chancellor for university advancement. The UNC-Chapel Hill Foundation Board may, in its discretion, elect one or two of its at-large members to the Investment Fund Board. The Investment Fund supports the University by operating an investment fund for charitable, non-profit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. Because members of the Board of Directors of the Investment Fund are officials or appointed by officials of the University and the Investment Fund's primary purpose is to benefit the University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

In December 2002, the System Fund was organized by the Investment Fund to allow the University, the University of North Carolina and its other constituent institutions (UNC System), affiliated foundations, associations, trusts, and endowments that support the University and the UNC System, to pool their resources and invest collectively in investment opportunities identified, structured and arranged by the Management Company. The membership interests are offered only to government entities or tax-exempt organizations that are controlled by or support the University or UNC System. The Investment Fund contributed and assigned all of its assets to the System Fund effective January 1, 2003, in exchange for its membership interest in the System Fund. Upon such contribution and assignment, and in consideration thereof, the System Fund has assumed all liabilities and obligations of the Investment Fund in respect of such contributed assets. At June 30, 2005, the Investment Fund membership interest was approximately 93 percent of the System Fund total membership interests. Because the Investment Fund is the organizer and a predominant member of the System Fund, the financial statements of the System Fund have been blended with those of the University.

The Management Company is a North Carolina non-profit corporation organized and operated exclusively to support the educational mission of the University. The Management Company will also provide investment management services to the University, UNC System, and institutions and affiliated tax-exempt organizations, and perform other functions for and generally carry out the purposes of the University. The Management Company is governed by five ex-officio directors and one or two additional directors as fixed or changed from time to time by the board, elected by the ex-officio directors. The ex-officio directors consist of the chancellor of the University, the vice chancellor for finance and administration of the University, the chairman of the University's Board of Trustees of the University, the chairman of the Board of Directors of the Investment Fund, and the president of the Management Company. Because members of the Board of Directors of the Management Company are officials or appointed by officials of the University and the Management Company's primary purpose is to benefit the University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University. Effective January 1, 2003, the Management Company entered into an investment services agreement with the System Fund pursuant to which it will provide investment management and administrative services to the System Fund and the University. Effective January 1, 2004, the Management Company entered into an investment services agreement with the System Fund pursuant to which it will provide investment management and administrative services to the UNC-Chapel Hill Foundation.

The UNC-Chapel Hill Foundation is governed by a 17-member board consisting of nine ex-officio directors and eight elected directors. Ex-officio directors include the chairman of the University Board of Trustees, the chancellor, the vice chancellor for finance and administration, and the vice chancellor for university advancement (nonvoting). In addition, the Board of Trustees elects two ex-officio directors from among its own members as

well as three ex-officio directors from the membership of the Board of Trustees of the Endowment Fund who have not otherwise been selected. The eight remaining directors are elected as members of the UNC-Chapel Hill Foundation Board of Directors by action of the ex-officio directors. The UNC-Chapel Hill Foundation aids, supports, and promotes teaching, research and service in the various educational, scientific, scholarly, professional, artistic and creative endeavors of the University. Because members of the Board of Directors of the UNC-Chapel Hill Foundation are officials or appointed by officials of the University and the UNC-Chapel Hill Foundation's sole purpose is to benefit the University, its financial statements have been blended with those of the University.

The Business School Foundation is governed by a board consisting of four ex-officio directors and four or more elected directors. Ex-officio directors include the dean of the Kenan-Flagler Business School (Business School), as well as the school's chief financial officer, associate dean of academic affairs, and associate dean for MBA Programs. The remaining directors are elected to the Business School Foundation Board of Directors by action of the ex-officio directors. The Business School Foundation aids, promotes and supports the Kenan-Flagler Business School at the University. Because members of the Board of Directors of the Business School Foundation are officials or appointed by officials of the University, the financial statements of the Business School Foundation have been blended with those of the University.

The Social Work Foundation is governed by a board consisting of three ex-officio directors and 10 elected directors. Ex-officio directors include the dean of the School of Social Work as well as the Chairman of the school's Board of Advisors and the assistant dean for external affairs. The remaining 10 directors are elected to the Social Work Foundation Board of Directors by action of the ex-officio directors. The Social Work Foundation fosters and promotes the growth, progress, and general welfare of social work practice and research at the School of Social Work of the University. Because members of the Board of Directors of the Social Work Foundation are officials or appointed by officials of the University, the financial statements of the Social Work Foundation have been blended with those of the University.

The Law Foundation is governed by a board consisting of one ex-officio director, six appointed directors and six elected directors. The ex-officio director is the dean of the School of Law of the University. The ex-officio director appoints six directors and the Board of Directors of the Law Alumni Association of the UNC, Inc. elects the other six directors. The Law Foundation provides support, fosters, and encourages the study and teaching of law at the University Law School. Because a majority of the members of the Board of Directors of the Law Foundation are officials or appointed by officials of the University, the financial statements of the Law Foundation have been blended with those of the University.

Separate financial statements for the Investment Fund, System Fund, the Management Company, and blended foundations may be obtained from the University Controller's Office, Campus Box

1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

Discretely Presented Component Units – The Medical Foundation of North Carolina, Inc. (Medical Foundation), The Educational Foundation Scholarship Endowment Trust (Educational Foundation Trust), and the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. (Arts and Sciences Foundation) are legally separate, non-profit, tax-exempt organizations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Medical Foundation is governed by an 83-member board of directors, elected annually by its members. Its purpose is to support educational and research efforts of the University's medical school and UNC Hospitals. Historically, the University's medical school has been the major recipient of financial support from the Medical Foundation compared to UNC Hospitals. Although the University does not control the timing or amount of receipts from the Medical Foundation, the majority of resources or income that the Medical Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Medical Foundation can only be used by, or for the benefit of the University, the Medical Foundation is considered a component unit of the University.

The Arts and Sciences Foundation is governed by a board consisting of three ex-officio directors, 24 elected directors and such number of emeritus directors determined from time to time by the board of directors. The 24 elected directors are elected for staggered terms, by the board of directors in office at the time of election. The purpose of the Arts and Sciences Foundation is to promote and support the University's College of Arts and Sciences. Although the University does not control the timing or amount of receipts from the Arts and Sciences Foundation, the majority of resources or income that the Arts and Sciences Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Arts and Sciences Foundation can only be used by, or for the benefit of the University, the Arts and Sciences Foundation is considered a component unit of the University.

The Educational Foundation Trust is governed by the Board of Trustees consisting of 10 trustees and the chairman of the executive committee, who also serves as a trustee during his or her term as chairman. The Educational Foundation Trust operates solely to assist the University in providing financial assistance to students at the University. On an annual basis, the Board of Trustees of the Educational Foundation Trust appropriates a portion of the net appreciation on its assets to the Educational Foundation, Inc. in its capacity as agent for the Educational Foundation Trust. The distribution from the Educational Foundation Trust to the Educational Foundation, Inc. is then forwarded by the Educational Foundation, Inc. to the University to provide financial assistance to students at the University. Although the University does not control the timing or amount of receipts from the Educational Foundation Trust, the majority of resources or income that the Educational Foundation Trust holds and invests are restricted

to the students of the University by the donors. Because these restricted resources held by the Educational Foundation Trust can only be used for the benefit of the students of the University, the Educational Foundation Trust is considered a component unit of the University.

The Medical Foundation, the Arts and Sciences Foundation and the Educational Foundation Trust are private, non-profit organizations that report their financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2005, the Medical Foundation, Arts and Sciences Foundation, and the Educational Foundation Trust distributed in total \$28,548,229 to the University for both restricted and unrestricted purposes. Complete financial statements for the Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust can be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

Other related foundations and similar non-profit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

B. Basis of Presentation – The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

Pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, the full scope of the University's activities is considered to be a single business-type activity and accordingly, is reported within a single column in the basic financial statements.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the University does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

C. Basis of Accounting – The financial statements of the University have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.

Nonexchange transactions, in which the University receives (or

gives) value without directly giving (or receiving) equal value in exchange includes state appropriations, certain grants, and donations. Revenues are recognized, net of estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection.

D. Cash and Cash Equivalents – This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, savings accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment portfolio. The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

E. Investments – This classification includes long-term fixed income investments, equity investments, mutual funds, money market funds, certificates of deposit, limited partnerships, real estate investment trusts, real estate, and other asset holdings by the University. Except for money market funds, certificates of deposit, real estate not held by a governmental external investment pool, and other asset holdings, investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market prices are not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

Money market funds, certificates of deposit, real estate not held by a governmental external investment pool, and other asset holdings are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

Short-term investments include marketable securities representing the investment of cash that is available for current operations. A majority of this available cash is invested in the University's Temporary Pool, a governmental external investment pool.

F. Receivables – Receivables consist of tuition and fees charged to students and charges to patients for services provided by the UNC Physicians & Associates and the Dental Faculty Practices. Receivables also include amounts due from the federal government, state and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied, and notes receivables from loans to students. Patients, pledges, and notes receivables are recorded net of the allowance for doubtful accounts. The accounts and other receivables are shown at book value with no provision for doubtful accounts considered necessary.

G. Inventories – Inventories held by the University are priced at cost or average cost except for the Student Stores inventory, which is valued at the lower of cost or market. Inventories consist of expendable supplies, postage, fuel held for consumption, textbooks, and other merchandise for resale.

H. Capital Assets – Capital assets are stated at cost at date of ac-

quisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

The University capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an expected useful life of more than one year. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line over the estimated useful lives of the assets, generally 10 to 40 years for general infrastructure, 10 to 50 years for buildings, and two to 10 years for equipment.

The University's historic property, artworks, and literary collections are capitalized at cost or fair value at the date of donation. These property and collections are considered inexhaustible and are therefore not depreciated.

I. Restricted Assets – Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. Certain other assets are classified as restricted because their use is limited by external parties or statute.

J. Funds Held in Trust for Pool Participants – Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2.

K. Funds Held in Trust by Others – Funds held in trust by others are resources neither in the possession nor the control of the University, but held and administered by an outside organization, with the University deriving income from such funds. Such funds established under irrevocable trusts where the University has legally enforceable rights or claims have not been recorded on the accompanying financial statements. The value of these assets at June 30, 2005 is approximately \$30,623,598.

L. Noncurrent Long-Term Liabilities – Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease obligations, annuity payable, and compensated absences that are not scheduled to be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums or discounts and deferred losses on refunds. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method. The deferred losses on refundings are amortized over the life of the old debt or new debt (whichever is shorter) using the straight-line method. Issuance costs are expensed.

M. Compensated Absences – The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days

which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

In addition to the vacation leave described above, compensated absences includes the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly to all full-time permanent employees as of September 30, 2002, and as of July 1, 2003. The unused portion of this leave remains available until used, notwithstanding the limitation on annual leave carried forward described above.

When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method.

There is no liability for unpaid accumulated sick leave because the University has no obligation to pay sick leave upon termination or retirement. However, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

N. Net Assets – The University's net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt – This represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted Net Assets – Non-expendable – Nonexpendable restricted net assets include endowments and similar type assets whose use is limited by donors or other outside sources, and, as a condition of the gift, the principal is to be maintained in perpetuity.

Restricted Net Assets – Expendable – Expendable restricted net assets include resources for which the University is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted Net Assets – Unrestricted net assets include resources derived from student tuition and fees, sales and services, unrestricted gifts, royalties, and interest income.

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. When both restricted and unrestricted funds are available for expenditure, the decision for funding is transactional based within the departmental management system in place at the University. For projects funded by tax-exempt debt proceeds and other sources, the debt proceeds are always used first.

O. Scholarship Discounts – Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. The scholarship discount is the difference between the actual charge for goods and services provided by the University and the amount that is paid by students or by third parties on the students' behalf. Student financial assistance grants, such as Pell grants, and other federal, state, or nongovernmental programs, are recorded as either operating or non-operating revenues in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount.

P. Revenue and Expense Recognition – The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, (3) certain federal, State and local grants and contracts that are essentially contracts for services, and (4) interest earned on loans. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions and state appropriations that represent subsidies or gifts to the University, as well as investment income, are considered nonoperating since these are either investing, capital or non-capital financing activities. Capital contributions are presented separately after nonoperating revenues and expenses.

Q. Internal Sales Activities – Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as utility services, telecommunications, central stores, printing and copy centers, postal services, repairs and maintenance services. In addition, the University has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to University departments from auxiliary operations and sales and service units have been eliminated in the accompanying financial statements. These eliminations are recorded by removing the revenue and expense in the auxiliary operations and sales and service units and, if significant, allocating any residual balances to those departments receiving the goods and services during the year.

R. Related Parties – Related parties are non-profit organizations established to assist and provide support to University

programs by funding scholarships, fellowships, professorships, and other needs of specific schools as well as the University's overall academic endeavors. Except as described in Note 1A, the University's financial statements do not include the assets, liabilities, net assets or operational transactions of these organizations except for support from each organization to the University.

Note 2: Deposits and Investments

A. Deposits – Unless specifically exempt, the University is required by *North Carolina General Statute* 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. In addition, the University of North Carolina Board of Governors, pursuant to G. S. 116-36.1, requires the University to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

At June 30, 2005, the University's deposit with the State Treasurer's Short-Term Investment Fund totaled \$456,047,648. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.41 years as of June 30, 2005. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

The carrying amount of the University's deposits not with the State Treasurer, including certificates of deposit, was \$4,315,153 and the bank balance was \$7,167,899. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2005, of the University's bank balance, \$6,079,538 was exposed to custodial credit risk as uninsured and uncollateralized.

B. Investments – The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds and funds received

for services rendered by health care professionals in the same manner as the State Treasurer is required to invest, as previously discussed.

G.S. 147-69.1(c), applicable to the State's General Fund, and G.S. 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; time deposits of specified institutions; prime quality commercial paper; and asset-backed securities with specified ratings. Also, G.S. 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. G.S. 147-69.2 authorizes the following: general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

In accordance with the bond resolutions, bond proceeds and debt service funds are invested in obligations that will by their terms mature on or before the date funds are expected to be required for expenditure or withdrawal.

G.S. 116-36(e) provides that the trustees of the Endowment Fund shall be responsible for the prudent investment of the fund in the exercise of their sound discretion, without regard to any statute or rule of law relating to the investment of funds by fiduciaries but in compliance with any lawful condition placed by the donor upon that part of the Endowment Fund to be invested.

Investments of the University's component units, UNC-Chapel Hill Foundation, Investment Fund, System Fund, Business School Foundation, Social Work Foundation, Law Foundation, Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust, are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

Investments of various funds may be pooled unless prohibited by statute or by terms of the gift or contract. The University utilizes investment pools to manage investments and distribute investment income.

The investments are subject to the following risks.

Interest Rate Risk: Interest rate risk is the risk the University may face should interest rate variances affect the fair value of investments. The University does not have a formal investment policy that addresses interest rate risk.

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University does not have a formal policy that addresses credit risk.

Custodial Credit Risk: Custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral

securities that are in the possession of an outside party. The University does not have a formal policy for custodial credit risk. At June 30, 2005, the University's investments were not exposed to custodial credit risk.

Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributed to the magnitude of a University investment in a single issuer. While the University does not have a formal investment policy limiting concentration exposure, risk of loss is mitigated by diversification as to investments by asset class and within asset classes. As of June 30, 2005, the University did not have any single investment that exceeded 5 percent of the total investments of the University.

Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates could adversely affect the fair value of an investment. The University does not have a formal policy for foreign currency risk.

Temporary Investment Pool (Temporary Pool) - This is a fixed income portfolio managed by the UNC Management Company, Inc. (Management Company) and Tanglewood Asset Management LLC. It operates in conjunction with the University's Bank of America disbursing account for all special funds, funds received for services rendered by health care professionals, and endowment revenue funds (internal portion) and funds of affiliated foundations (external portion). Because of the participation in the Temporary Pool by affiliated foundations, it is considered a governmental external investment pool. The external portion of the Temporary Pool is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. The Temporary Pool is not registered with the SEC and the University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Temporary Pool.

The Northern Trust Company is the custodian for the Temporary Pool and provides the University with monthly statements defining income and market value information. Investments of the Temporary Pool are highly liquid and generally include U.S. government securities, collateralized mortgage obligations, corporate bonds, mutual funds, and money market funds. The University has elected to invest a portion of the Temporary Pool assets in the University's Investment Fund.

Through written request to accounting services, participants may purchase and sell shares in the Temporary Pool at a fixed value of \$1 per share. Generally, the purchase and sale of participation shares occur only at the beginning of the month. Income distribution is determined each quarter by multiplying the distribution rate by the average of the invested fund balance. Statements are provided via internet website to each participating account or group of accounts on a quarterly basis reflecting the participants' balance and income distribution. The rate earned by an account is dependent upon its account classification and investable fund balance. The rates are set in coordination between the Management Company and the vice chancellor for finance and administration.

The following table presents the fair value of the Temporary Pool investments by type and investments subject to interest rate risk at June 30, 2005.

Temporary Pool Investments

| Investment Type | Fair Value | Investment Maturities (in Years) | | | |
|---|----------------------|----------------------------------|---------------------|---------------------|----------------------|
| | | Less Than 1 | 1 to 5 | 6 to 10 | More than 10 |
| Debt Securities | | | | | |
| U.S. Treasuries | \$25,243,204 | | \$25,243,204 | | |
| U.S. Agencies | 27,329,296 | \$4,905,745 | 13,625,110 | \$8,307,881 | \$490,560 |
| Mortgage Pass Throughs | 56,582,945 | 90,984 | 13,342,629 | 5,824,259 | 37,325,073 |
| Collateralized Mortgage Obligations | 91,465,162 | | 1,727,159 | | 89,738,003 |
| State and Local Government | 2,809,248 | | 2,809,248 | | |
| Asset-backed securities | 3,443,672 | | 640,254 | 2,304,733 | 498,685 |
| Mutual Bond Funds | 14,229,168 | 543,250 | 805,800 | 3,646,168 | 9,233,950 |
| Domestic Corporate Bonds | 13,336,223 | 455,303 | 6,875,810 | 1,824,722 | 4,180,388 |
| Foreign Corporate Bonds | 5,000,000 | | | 5,000,000 | |
| Money Market Funds | 78,634,154 | 78,634,154 | | | |
| Total Debt Securities | 318,073,072 | \$84,629,436 | \$65,069,214 | \$26,907,763 | \$141,466,659 |
| Other Securities | | | | | |
| Certificates of Deposit | 1,000,000 | | | | |
| Domestic Stocks | 30,000 | | | | |
| Total Temporary Pool Investments | \$319,103,072 | | | | |

Certificates of deposit reported as investments are also a component of the deposit totals reported in the deposits section of this note.

As of June 30, 2005, the investments subject to credit risk in the Temporary Pool were rated as follows:

| | Fair Value | AAA Aaa | AA Aa | A | BBB Baa | BB Ba | Unrated |
|-------------------------------------|----------------------|---------------------|---------------------|----------------------|------------------|--------------------|---------------------|
| U.S. Agencies | \$24,265,502 | \$17,251,170 | \$3,218,922 | | | | \$3,795,410 |
| Mortgage Pass Throughs | 32,091,752 | | | | | | 32,091,752 |
| Collateralized Mortgage Obligations | 91,465,162 | 44,969,848 | 11,129,290 | \$29,085,252 | | | 6,280,772 |
| State and Local Government | 2,809,248 | 2,809,248 | | | | | |
| Asset-backed securities | 3,443,672 | 2,488,565 | | 456,422 | \$498,685 | | |
| Mutual Bond Funds | 14,229,168 | 4,012,950 | 805,800 | 9,410,418 | | | |
| Domestic Corporate Bonds | 13,336,223 | 3,435,741 | | 8,015,260 | | \$1,885,222 | |
| Foreign Corporate Bonds | 5,000,000 | | 5,000,000 | | | | |
| Money Market Funds | 78,634,154 | | | 78,634,154 | | | |
| Total | \$265,274,881 | \$74,967,522 | \$20,154,012 | \$125,601,506 | \$498,685 | \$1,885,222 | \$42,167,934 |

Rating Agencies: Moody's / Standard & Poor's

Since a separate annual financial report of the Temporary Investment Pool has not and is not planned to be issued, the following additional disclosures are being provided in the University's financial statements.

The Temporary Investment Pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2005 are as follows:

Statement of Net Assets

June 30, 2005

| | AMOUNT |
|---|----------------------|
| Assets: | |
| Accrued Investment Income | \$1,579,657 |
| Investments Fund Equity | 36,056,153 |
| Investments | 319,103,072 |
| Total Assets | \$356,738,882 |
| Liabilities: | |
| Deferred Income | \$867,678 |
| Total Liabilities | 867,678 |
| Net Assets: | |
| Internal Portion | 231,209,521 |
| External Portion | 124,661,683 |
| Total Net Assets | 355,871,204 |
| Total Liabilities and Net Assets | \$356,738,882 |

Statement of Operations and Changes in Net Assets

for the Fiscal Year Ended June 30, 2005

| | AMOUNT |
|---|----------------------|
| Increase in Net Assets from Operations: | |
| Revenues: | |
| Investment Income | \$14,707,512 |
| Expenses: | |
| Investment Management | 412,812 |
| Net Increase in Net Assets Resulting from Operations | 14,294,700 |
| Distributions to Participants: | |
| Distributions Paid and Payable | 14,294,700 |
| Share Transactions: | |
| Net Share Purchases | 52,673,549 |
| Total Increase in Net Assets | 52,673,549 |
| Net Assets: | |
| Beginning of Year | 303,197,655 |
| End of Year | \$355,871,204 |

UNC-Chapel Hill Foundation Investment Fund Inc. (Investment Fund) – This is a North Carolina non-profit corporation exempt from income tax pursuant to Section 501(c)(3). It was established in January 1997 and is classified as a governmental external investment pool. The pool is utilized to manage the investments for charitable, non-profit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. The University's Endowment, UNC-Chapel Hill Foundation, Business School Foundation, Social Work Foundation, Law Foundation, Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust are participants in the Investment Fund and are included in the University's reporting entity (internal portion). Other affiliated organizations (external portion) in the Investment Fund are not included in the University's reporting entity. Fund ownership of the University's Investment Fund is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The external portion of the Investment Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants.

The Investment Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Investment Fund Board of Directors (See Note 1 A).

The Northern Trust Company is the custodian for the Investment Fund and provides the University with monthly statements defining income and market value information. The Investment Fund uses a unit basis to determine each participant's market value and to distribute the fund's earnings according to the fund's spending policy. There are no involuntary participants in the Investment Fund. The University has not provided or obtained any legally binding guarantees during the period to support the value for the Investment Fund. The audited financial statements for the Investment Fund may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

The Investment Fund consists of an approximately 93 percent membership in the System Fund categorized below.

UNC Investment Fund, LLC (System Fund) – This is a limited liability company organized under the laws of the State of North Carolina. It was established in December 2002 by the Investment Fund and is classified as a governmental external investment pool. The pool is utilized to manage the investments for The University of North Carolina, its constituent institutions, and affiliates of the constituent institutions. This includes charitable, non-profit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support these institutions. The Investment Fund, with an approximately 93 percent membership interest as of June 30, 2005, is the predominant member of the System Fund. The University's reporting entity portion of the Investment Fund is characterized as the internal portion. Other affiliated organizations in the Investment Fund in addition to other members of the System Fund not included in the University's reporting entity are characterized as the external portion. The external portion of the System Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Membership interests of the System Fund are measured using the unit value method. Under this method, each member's investment balance is determined on a market value basis.

The System Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Investment Fund as the controlling member and the Management Company (See Note 1 A). Effective January 1, 2003, the Management Company entered into an investment management services agreement with the System Fund and will provide investment management and administrative services.

The Northern Trust Company is the custodian for the System Fund and provides the University with monthly statements defining income and market value information. The System Fund uses a unit basis to determine each member's market value and to distribute the fund's earnings. There are no involuntary participants in the System Fund. The University has not provided or obtained any legally binding guarantees during the period to support the value for the System Fund investments. The audited financial statements for the System Fund may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

The following table presents the fair value of the System Fund investments by type and investments subject to interest rate risk at June 30, 2005.

System Fund Pool Investments

| Investment Type | Fair Value | Investment Maturities (in Years) | | | |
|---|------------------------|----------------------------------|------------------|---------------------|---------------------|
| | | Less Than 1 | 1 to 5 | 6 to 10 | More than 10 |
| Debt Securities | | | | | |
| U.S. Treasuries | \$23,022,627 | | | | \$23,022,627 |
| U.S. Agencies | 1,473,045 | | | \$146,003 | 1,327,042 |
| Mortgage Pass Throughs | 2,790,000 | | | 2,790,000 | |
| Collateralized Mortgage Obligations | 5,617,198 | | | | 5,617,198 |
| Mutual Bond Funds | 13,489,063 | | \$917,980 | 9,424,742 | 3,146,341 |
| Domestic Corporate Bonds | 10,973,212 | | | 67,320 | 10,905,892 |
| Foreign Corporate Bonds | 4,391,417 | | | 4,391,417 | |
| Money Market Funds | 24,085,592 | \$24,085,592 | | | |
| Total Debt Securities | 85,842,154 | \$24,085,592 | \$917,980 | \$16,819,482 | \$44,019,100 |
| Other Securities | | | | | |
| Other Money Market Funds | 7,077,361 | | | | |
| Other Mutual Funds | 37,048,495 | | | | |
| Limited Partnerships | 658,620,903 | | | | |
| Domestic Stocks | 53,937,314 | | | | |
| Foreign Stocks | 4,209,639 | | | | |
| Hedge Equity | 455,140,674 | | | | |
| Total System Fund Pool Investments | \$1,301,876,540 | | | | |

As of June 30, 2005, the investments subject to credit risk in the System Fund were rated as follows:

| | Fair Value | AAA Aaa | AA Aa | A | BBB Baa | BB Ba | Unrated |
|-------------------------------------|---------------------|---------------------|--------------------|---------------------|--------------------|--------------------|--------------------|
| U.S. Agencies | \$1,327,042 | \$1,327,042 | | | | | |
| Mortgage Pass Throughs | 2,790,000 | 2,790,000 | | | | | |
| Collateralized Mortgage Obligations | 5,617,198 | 4,585,858 | \$1,031,340 | | | | |
| Mutual Bond Funds | 13,489,063 | 1,678,180 | 3,634,591 | | \$750,406 | | \$7,425,886 |
| Domestic Corporate Bonds | 10,973,212 | | | \$5,240,960 | 5,664,932 | | 67,320 |
| Foreign Corporate Bonds | 4,391,417 | | | | | \$4,391,417 | |
| Money Market Funds | 24,085,592 | | | 24,085,592 | | | |
| Total | \$62,673,524 | \$10,381,080 | \$4,665,931 | \$29,326,552 | \$6,415,338 | \$4,391,417 | \$7,493,206 |

Rating Agencies: Moody's / Standard & Poor's

As of June 30, 2005, the University's exposure to foreign currency risk for the System Fund investments was as follows:

| Investment | Currency | Fair Value (U.S. Dollars) |
|----------------------|------------------------|------------------------------|
| Limited Partnerships | Euro | \$15,952,284 |
| Limited Partnerships | British Pound Sterling | 3,612,231 |
| Total | | \$19,564,515 |

In addition to the foreign currency risk disclosed above, the System Fund includes investments with fair values highly sensitive to interest rate changes. The System Fund invests in a Hedge Fund that contains securities that are highly sensitive to rate changes.

Non-Pooled Investments - The following table presents the fair value of the Non-Pooled investments by type and investments subject to interest rate risk at June 30, 2005.

Non-Pooled Investments

| Investment Type | Fair Value | Investment Maturities (in Years) | | | |
|-------------------------------------|----------------------|----------------------------------|--------------------|---------------------|--------------------|
| | | Less Than 1 | 1 to 5 | 6 to 10 | More than 10 |
| Debt Securities | | | | | |
| U.S. Treasuries | \$744,596 | \$175,344 | \$124,305 | \$109,577 | \$335,370 |
| U.S. Treasury Strips | 2,645,843 | | 2,308,901 | 336,942 | |
| U.S. Agencies | 446,800 | | 269,274 | 151,776 | 25,750 |
| Mortgage Pass Throughs | 1,298,948 | | 19,446 | 22,505 | 1,256,997 |
| Collateralized Mortgage Obligations | 937,834 | | 53,355 | | 884,479 |
| State and Local Government | 154,985 | | 31,839 | 39,459 | 83,687 |
| Mutual Bond Funds | 14,732,368 | | 2,551,110 | 11,780,818 | 400,440 |
| Domestic Corporate Bonds | 265,463 | | 196,296 | | 69,167 |
| Total Debt Securities | 21,226,837 | \$175,344 | \$5,554,526 | \$12,441,077 | \$3,055,890 |
| Other Securities | | | | | |
| Other Money Market Funds | 31,784,547 | | | | |
| Other Mutual Funds | 47,251,493 | | | | |
| Investments in Real Estate | 15,057,965 | | | | |
| Domestic Stocks | 13,021,313 | | | | |
| Foreign Stocks (ADR's) | 6,658 | | | | |
| Other | 4,980,637 | | | | |
| Total Non-Pooled Investments | \$133,329,450 | | | | |

As of June 30, 2005, the University's Non-Pooled investments subject to credit risk were rated as follows:

| | Fair Value | AAA Aaa | AA Aa | A | BBB Baa | BB Ba | B | Unrated |
|-------------------------------------|---------------------|--------------------|------------------|------------------|------------------|-----------------|------------------|---------------------|
| U.S. Agencies | \$404,880 | \$372,518 | | | | | | \$32,362 |
| Mortgage Pass Throughs | 1,108,958 | | | | | | | 1,108,958 |
| Collateralized Mortgage Obligations | 937,834 | 406,579 | | \$377,113 | \$103,814 | | | 50,328 |
| State and Local Government | 154,985 | 31,839 | | | | | | 123,146 |
| Mutual Bond Funds | 14,732,368 | 1,387,407 | \$953,432 | 325,090 | 801,011 | | \$296,842 | 10,968,586 |
| Domestic Corporate Bonds | 265,463 | | 29,539 | 180,617 | | \$55,307 | | |
| Total | \$17,604,488 | \$2,198,343 | \$982,971 | \$882,820 | \$904,825 | \$55,307 | \$296,842 | \$12,283,380 |

Rating Agencies: Moody's / Standard & Poor's

Total Investments – The following table presents the fair value of the total investments at June 30, 2005.

Total Investments

| Investment Type | Fair Value |
|-------------------------------------|------------------------|
| Debt Securities | |
| U.S. Treasuries | \$49,010,427 |
| U.S. Treasury Strips | 2,645,843 |
| U.S. Agencies | 29,249,141 |
| Mortgage Pass Throughs | 60,671,893 |
| Collateralized Mortgage Obligations | 98,020,194 |
| State and Local Government | 2,964,233 |
| Asset-backed Securities | 3,443,672 |
| Mutual Bond Funds | 42,450,599 |
| Domestic Corporate Bonds | 24,574,898 |
| Foreign Corporate Bonds | 9,391,417 |
| Money Market Funds | 102,719,746 |
| Total Debt Securities | 425,142,063 |
| Other Securities | |
| Certificates of Deposit | 1,000,000 |
| Other Money Market Funds | 38,861,908 |
| Other Mutual Funds | 84,299,988 |
| Investments in Real Estate | 15,057,965 |
| Limited Partnerships | 658,620,903 |
| Domestic Stocks | 66,988,627 |
| Foreign Stocks | 4,216,297 |
| Other | 460,121,311 |
| Total Investments | \$1,754,309,062 |

Total investments include \$235,462,764 held in the System Fund for the component units that are discretely presented in the accompanying financial statements. The University's reporting entity, including the three discretely presented component units, comprises 85.03 percent of the System Fund.

Note 3: Endowment Investment Return

Substantially all of the investments of the University's endowment funds are pooled in the Investment Fund. Investment return of the University's pooled endowment funds is predicated on the total return concept (yield plus appreciation). Annual distributions from the Investment Fund to the University's pooled endowment funds are generally based on an adopted distribution

policy. Under this policy, the prior year distribution is increased by the rate of inflation as measured by the Consumer Price Index (CPI). Each year's distribution, however, is subject to a minimum of 4 percent and a maximum of 7 percent of the pooled endowment fund's average market value for the previous year.

To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not meet the distribution requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2005, accumulated income and appreciation of \$404,406,631 was available in the University's pooled endowment funds of which \$366,483,954 was restricted to specific purposes.

Note 4: Receivables

Receivables at June 30, 2005, were as follows:

| | Gross Receivables | Less Allowance for Doubtful Accounts | Net Receivables |
|---|----------------------|---|----------------------|
| Current Receivables: | | | |
| Students | \$2,144,213 | | \$2,144,213 |
| Patients | 70,863,703 | (\$44,086,413) | 26,777,290 |
| Accounts | 32,507,077 | | 32,507,077 |
| Intergovernmental | 31,782,956 | | 31,782,956 |
| Pledges | 17,696,035 | (442,401) | 17,253,634 |
| Investment Earnings | 2,840,889 | | 2,840,889 |
| Interest on Loans | 608,032 | | 608,032 |
| Other | 10,349 | | 10,349 |
| Total Current Receivables | \$158,453,254 | (\$44,528,814) | \$113,924,440 |
| Non-current Receivables: | | | |
| Pledges | \$31,098,568 | (\$777,465) | \$30,321,103 |
| Notes Receivable: | | | |
| Notes Receivable – Current: | | | |
| Federal Loan Programs | \$2,795,462 | (\$143,164) | \$2,652,298 |
| Institutional Student Loan Programs | 757,004 | (35,925) | 721,079 |
| Other Notes Receivable | 312,791 | | 312,791 |
| Total Notes Receivable – Current | \$3,865,257 | (\$179,089) | \$3,686,168 |
| Notes Receivable – Non-current: | | | |
| Federal Loan Programs | \$25,998,673 | (\$1,288,480) | \$24,710,193 |
| Institutional Student Loan Programs | 4,305,069 | (119,963) | 4,185,106 |
| Other Notes Receivable | 150,000 | | 150,000 |
| Total Notes Receivable – Non-current | \$30,453,742 | (\$1,408,443) | \$29,045,299 |

Pledges are receivable over varying time periods ranging from one to 10 years, and have been discounted based on a projected interest rate of 3.58 percent for the outstanding periods, and allowances are provided for the amounts estimated to be uncollectible.

Scheduled receipts, the discounted amount under these pledge commitments, and allowances for uncollectible pledges are as follows:

| Fiscal Year | Amount |
|---|---------------------|
| 2006 | \$17,696,035 |
| 2007 | 13,733,006 |
| 2008 | 6,997,543 |
| 2009 | 4,757,578 |
| 2010 | 1,914,839 |
| 2011–2015 | 8,214,392 |
| Total Pledge Receipts Expected | 53,313,393 |
| Discount Amount Representing Interest (3.58% Rate of Interest) | (4,518,791) |
| Present Value of Pledge Receipts Expected | 48,794,602 |
| Less Allowance for Uncollectible Pledges | (1,219,865) |
| Pledges Receivable | \$47,574,737 |

Note 5: Capital Assets

A summary of changes in the capital assets for the year ended June 30, 2005, is presented as follows:

| | Balance July 1, 2004 | Adjustments | Increases | Decreases | Balance June 30, 2005 |
|--|-------------------------|-----------------|----------------------|--------------------|--------------------------|
| Capital Assets, Non-depreciable: | | | | | |
| Land | \$26,339,081 | | \$1,136,117 | \$1,405,676 | \$26,069,522 |
| Art, Literature, and Artifacts | 57,764,135 | | 1,627,375 | 113,580 | 59,277,930 |
| Construction in Progress | 219,339,291 | (\$103,189,790) | 261,374,264 | 1,347 | 377,522,418 |
| Intangible Assets | 1,000,000 | | | | 1,000,000 |
| Total Capital Assets, Nondepreciable | 304,442,507 | (103,189,790) | 264,137,756 | 1,520,603 | 463,869,870 |
| Capital Assets, Depreciable: | | | | | |
| Buildings | 1,091,776,409 | 85,274,705 | 44,655,253 | 872,886 | 1,220,833,481 |
| Machinery and Equipment | 213,504,724 | | 17,960,961 | 9,201,510 | 222,264,175 |
| General Infrastructure | 336,394,964 | 17,915,085 | 10,999,980 | | 365,310,029 |
| Total Capital Assets, Depreciable | 1,641,676,097 | 103,189,790 | 73,616,194 | 10,074,396 | 1,808,407,685 |
| Less Accumulated Depreciation/Amortization for: | | | | | |
| Buildings | 388,230,088 | | 34,967,811 | 544,972 | 422,652,927 |
| Machinery and Equipment | 132,414,021 | | 11,222,733 | 6,929,784 | 136,706,970 |
| General Infrastructure | 148,805,154 | | 13,911,366 | | 162,716,520 |
| Total Accumulated Depreciation | 669,449,263 | | 60,101,910 | 7,474,756 | 722,076,417 |
| Total Capital Assets, Depreciable, Net | 972,226,834 | 103,189,790 | 13,514,284 | 2,599,640 | 1,086,331,268 |
| Capital Assets, Net | \$1,276,669,341 | \$0 | \$277,652,040 | \$4,120,243 | \$1,550,201,138 |

Note 6: Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities at June 30, 2005, were as follows:

| | Amount |
|---|---------------------|
| Accounts Payable | \$55,190,176 |
| Accrued Payroll | 22,663,985 |
| Contract Retainage | 12,569,153 |
| Other | 193,965 |
| Total Accounts Payable and Accrued Liabilities | \$90,617,279 |

Note 7: Short-Term Debt

Short-term debt activity for the year ended June 30, 2005, was as follows:

| | Balance July 1, 2004 | Issued | Redeemed | Balance June 30, 2005 |
|---------------------------------|-------------------------|----------------------|------------|--------------------------|
| Commercial Paper Program | \$8,841,000 | \$132,300,000 | \$0 | \$141,141,000 |

Commercial paper was issued from the University of North Carolina General Revenue Bonds, Series 2002A, to provide interim financing for the construction of capital projects.

Note 8: Long-Term Liabilities

A. Changes in Long-Term Liabilities – A summary of changes in the long-term liabilities for the year ended June 30, 2005, is presented as follows:

| | Balance July 1, 2004 | Additions | Reductions | Balance June 30, 2005 | Current Portion |
|-------------------------------------|-------------------------|---------------------|---------------------|--------------------------|----------------------|
| Bonds Payable | \$519,740,000 | | \$18,920,000 | \$500,820,000 | \$112,857,582 |
| Add/Deduct Premium/Discount | (45,450,320) | | (3,003,454) | (42,446,866) | |
| Deduct Deferred Charge on Refunding | (2,605,803) | | (325,725) | (2,280,078) | |
| Total Bonds Payable | 471,683,877 | | 15,590,821 | 456,093,056 | 112,857,582 |
| Notes Payable | 35,000,000 | \$19,729,724 | 21,210,255 | 33,519,469 | 27,389,745 |
| Capital Leases Payable | 1,320,414 | 426,628 | 777,394 | 969,648 | 589,882 |
| Compensated Absences | 90,014,462 | 46,528,757 | 47,754,641 | 88,788,578 | 3,812,522 |
| Annuity and Life Income Payable | 6,666,847 | 278,876 | 419,524 | 6,526,199 | 824,356 |
| Total Long-Term Liabilities | \$604,685,600 | \$66,963,985 | \$85,752,635 | \$585,896,950 | \$145,474,087 |

Additional information regarding capital lease obligations is included in Note 9.

B. Bonds Payable – The University was indebted for bonds payable for the purposes shown in the following table:

| Purpose | Series | Interest Rate/ Ranges | Final Maturity Date | Original Amount of Issue plus Capital Appreciation | Principal Paid Through 06/30/2005 | Discount on Capital Appreciation Bonds | Principal Outstanding 06/30/2005 |
|--------------------------------------|--------|--------------------------|---------------------|--|-----------------------------------|--|----------------------------------|
| Housing System | | | | | | | |
| | 1997A | 4.500% – 5.100% | 11/01/2017 | \$9,170,000 | \$2,060,000 | | \$7,110,000 |
| | 1997B | 4.000% – 5.000% | 11/01/2011 | 7,210,000 | 1,985,000 | | 5,225,000 |
| Total Housing System | | | | 16,380,000 | 4,045,000 | | 12,335,000 |
| Utilities System | 1997 | 5.250% – 5.500% | 08/01/2021 | 84,135,000 | | \$(38,372,357) | 45,762,643 |
| Parking System | | | | | | | |
| | 1997A | 4.350%–5.700% | 05/15/2027 | 11,750,000 | 1,320,000 | | 10,430,000 |
| | 1997B | 3.900% – 5.150% | 05/15/2009 | 8,245,000 | 4,890,000 | | 3,355,000 |
| Total Parking System | | | | 19,995,000 | 6,210,000 | | 13,785,000 |
| General Revenue | | | | | | | |
| | 2001A | 2.900% –5.125% | 12/01/2025 | 89,930,000 | 7,875,000 | | 82,055,000 |
| | 2001B | variable | 12/01/2025 | 54,970,000 | 6,795,000 | | 48,175,000 |
| | 2001C | variable | 12/01/2025 | 54,970,000 | 6,795,000 | | 48,175,000 |
| | 2002B | 3.500% – 5.000% | 12/01/2011 | 66,555,000 | 13,720,000 | | 52,835,000 |
| | 2003 | 2.000% – 5.000% | 12/01/2033 | 107,960,000 | 990,000 | | 106,970,000 |
| Total General Revenue | | | | 374,385,000 | 36,175,000 | | 338,210,000 |
| Student Union | 2000 | 4.550% – 5.659% | 6/1/2022 | 12,465,000 | 1,450,000 | | 11,015,000 |
| Student Recreation Center | 1997 | 3.900% – 5.000% | 6/1/2011 | 3,545,000 | 1,365,000 | | 2,180,000 |
| U.S. EPA Project | 1991 | 8.250% – 9.050% | 2/15/2015 | 58,125,000 | 19,225,000 | (11,842,615) | 27,057,385 |
| U.S. EPA Project | 1996 | 6.720% | 2/15/2006 | 2,400,000 | 2,140,000 | | 260,000 |
| Total Bonds Payable (principal only) | | | | \$571,430,000 | \$70,610,000 | \$(50,214,972) | 450,605,028 |
| Less: Unamortized Loss on Refunding | | | | | | | (2,280,078) |
| Plus: Unamortized Premium | | | | | | | 7,768,106 |
| Total Bonds Payable | | | | | | | \$456,093,056 |

C. Demand Bonds – Included in bonds payable are two variable rate demand bond issues. Demand bonds are securities that contain a “put” feature that allows bondholders to demand payment before the maturity of the debt upon proper notice to the University’s remarketing or paying agents.

With regards to the following demand bonds, the University has not entered into legal agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

General Revenue, Series 2001B and 2001C:

In 2001, the University issued two series of variable rate demand bonds in the amount of \$54,970,000 (2001B) and \$54,970,000 (2001C) that each have a final maturity date of December 1, 2025, and are repaid from available funds. Available Funds are defined as any Unrestricted Net Assets remaining after satisfying obligations of the University under trust indentures, trust agreements or bond resolutions (specific revenue bonds), but excluding state appropriations, tuition, restricted gifts, and certain facilities revenues. The bonds are subject to mandatory sinking fund redemption on the interest payment date on or immediately preceding each December throughout the term of the bonds. The proceeds of these issuances were used to provide funds to refund in advance of their maturity the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Kenan Stadium, Series 1996; and Parking System, Series 1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University’s remarketing agents, Lehman Brothers, Inc (2001B) and UBS Financial Services, Inc. (2001C).

The University renewed its line of credit, in the amount of \$107,460,000, with JP Morgan Chase Bank effective February 2, 2005. Under the line of credit agreement, the University is entitled to draw amounts sufficient to pay the principal, and accrued interest on bonds delivered for purchase.

The University is required to pay a quarterly commitment fee for the line of credit of 0.13 percent per annum based on the unused portion of the line of credit commitment. If the University's credit rating for unsecured debt were to drop below "Aa3" (or its equivalent) by Moody's, "AA-" (or its equivalent) by S&P, or "AA-" (or its equivalent) by Fitch, the quarterly commitment fee would increase to 0.18 percent. If the University's credit rating for unsecured debt were to drop below "A3" (or its equivalent) by Moody's, "A-" (or its equivalent) by S&P, or "A-" (or its equivalent) by Fitch, the quarterly commitment fee would increase to 0.28 percent. Additionally, if the University were to terminate the line of credit prior to February 1, 2006, then the University must pay a termination fee of \$50,000 less any unused commitment fees paid to date.

Under the line of credit agreement, the University has promised to repay loans that represent purchase drawings in equal semi-annual payments after termination of the line of credit. Interest at the rate of Prime plus one percent (Prime plus two percent after 60 days) is payable quarterly and upon draw repayment. At June 30, 2005, no purchase draws had been made under the letter of credit.

The line of credit agreement expires on February 1, 2006. However, between November 3, 2005, and December 3, 2005, the University may request that the bank extend the expiration date for another year. The bank shall respond affirmatively or negatively within 30 days after receipt of such request.

In the event of termination of the line of credit, outstanding principal is to be repaid in semi-annual installments of principal on each February 1 and August 1, commencing on the first of such dates succeeding the termination date with the remaining principal amount payable on the second anniversary of the termination date. Further, accrued interest will continue to be due and payable on the first day of the calendar quarter and on the date any portion of principal is payable.

In order to protect against the risk of interest rate changes, effective October 3, 2000, the University entered into an interest rate swap agreement with Lehman Brothers Special Financing, Inc. (Lehman Brothers) related to \$22,000,000 of The University of North Carolina at Chapel Hill Variable Rate Housing System Revenue Bonds, Series 2000. This series of bonds was refunded in its entirety by the issuance of the University's Variable Rate General Revenue Bonds, Series 2001B (2001B Bonds), and the interest rate swap agreement was amended to reflect the refunding.

Under this amended agreement, Lehman Brothers pays the University interest on the notional amount based on the Bond Market Association (BMA) Municipal Bond Index on a quarterly basis. On a semiannual basis, the University pays Lehman Brothers interest at the fixed rate of 5.24 percent. The notional amount of the swap reduces annually in conjunction with the 2001B Bonds; the reductions began in November 2002 and end in November 2025. The swap agreement matures November 1, 2025. As of June 30, 2005, rates were as follows:

| | Terms | Rates % |
|------------------------------------|-------|-------------|
| Fixed payment to Lehman | Fixed | 5.24 |
| Variable payment from Lehman | BMA | <u>2.13</u> |
| Net interest rate swap payments | | 3.11 |
| Variable rate bond coupon payments | | <u>2.43</u> |
| Synthetic interest rate on bonds | | 5.54 |

As of June 30, 2005, the swap had a negative fair value of \$4,604,713. The fair value was developed by Lehman Brothers. Their method calculates the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for London Interbank Offered Rate (LIBOR) due on the date of each future net settlement on the swap.

As of June 30, 2005, the University was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the University would be exposed to credit risk in the amount of the derivative's positive fair value. Should the swap have a positive fair value of more than \$1,000,000, at that point Lehman would be required to collateralize 103 percent of their exposure. Lehman Brothers Holdings, guarantor of Lehman Brothers Special Financing, Inc., was rated A1 by Moody's Investor's Service, A by Standard and Poor's Corporation, and A+ by Fitch Ratings.

The University receives the BMA Index from Lehman Brothers and pays a floating rate to its bondholders set by the remarketing agent. The University incurs basis risk when its bonds begin to trade at a yield above the BMA. Basis risk also exists since swap payments are made quarterly while bond payments are made monthly. With the alternative tax structure of the swap, a change in tax law would trigger the swap being converted from a BMA swap to a percentage of LIBOR swap. This would introduce basis risk. If the weekly reset interest rates on the University's bonds are in excess of 65 percent of LIBOR, the University will experience an increase in debt service above the fixed rate on the swap to the extent that the interest rates on the bonds exceed 65 percent of LIBOR.

The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the University being required to make an unanticipated termination payment. The swap terminates if the University or Lehman Brothers fails to perform under terms of the contract.

As rates vary, variable rate bond interest payments and net swap payments will vary. Using rates as of June 30, 2005, debt service requirements of the variable rate debt and net swap payments, assuming current interest rates remain the same for the their term, are as follows.

| General Revenue Bonds, Series 2001B | | | | |
|-------------------------------------|---------------------|---------------------|---------------------------|---------------------|
| Fiscal Year | Principal | Interest | Interest Rate Swaps, Net* | Total |
| 2006 | \$2,060,000 | \$1,145,624 | \$659,398 | \$3,865,022 |
| 2007 | 2,140,000 | 1,094,594 | 651,623 | 3,886,217 |
| 2008 | 2,175,000 | 1,042,166 | 643,459 | 3,860,625 |
| 2009 | 2,285,000 | 987,977 | 634,984 | 3,907,961 |
| 2010 | 2,405,000 | 930,994 | 626,199 | 3,962,193 |
| 2011-2015 | 12,480,000 | 3,738,920 | 2,918,813 | 19,137,733 |
| 2016-2020 | 11,800,000 | 2,264,639 | 2,224,972 | 16,289,611 |
| 2021-2025 | 10,435,000 | 948,854 | 1,050,247 | 12,434,101 |
| 2026 | 2,395,000 | 29,099 | 32,500 | 2,456,599 |
| Total | \$48,175,000 | \$12,182,867 | \$9,442,195 | \$69,800,062 |

* Computed using $(5.24\% - 2.13\%) \times (\$22,000,000 - \text{annual swap reduction})$

D. Capital Appreciation Bonds – The University's Series 1997 Utility System and the Series 1991 U. S. Environmental Protection Agency Project bond issues include capital appreciation bonds with an original issue amount of \$30,379,142 and \$3,828,921, respectively. These bonds are recorded in the amounts of \$45,762,643 (\$84,135,000 ultimate maturity less \$38,372,357 discount) and \$13,432,385 (\$25,275,000 ultimate maturity less \$11,842,615 discount), respectively, which is the accreted value at June 30, 2005. These bonds mature in the years from 2010 to 2021.

E. Annual Requirements – The annual requirements to pay principal and interest on the long-term obligations at June 30, 2005, are as follows:

| Annual Requirements | | | | |
|---------------------------|----------------------|----------------------|---------------------|------------------|
| Fiscal Year | Bonds Payable | | Notes Payable | |
| | Principal | Interest | Principal | Interest |
| 2006 | \$20,840,000 | \$17,705,888 | \$27,389,745 | \$529,606 |
| 2007 | 21,635,000 | 16,709,429 | 6,129,724 | 85,129 |
| 2008 | 22,645,000 | 15,661,387 | | |
| 2009 | 23,920,000 | 14,525,014 | | |
| 2010 | 24,345,000 | 13,306,686 | | |
| 2011-2015 | 126,450,000 | 54,649,767 | | |
| 2016-2020 | 110,535,000 | 39,675,444 | | |
| 2021-2025 | 88,365,000 | 23,762,069 | | |
| 2026-2030 | 37,320,000 | 9,713,946 | | |
| 2031-2034 | 24,765,000 | 2,552,125 | | |
| Total Requirements | \$500,820,000 | \$208,261,755 | \$33,519,469 | \$614,735 |

Interest on the variable rate General Revenue Bonds 2001B is calculated at 2.43% at June 30, 2005

Interest on the variable rate General Revenue Bonds 2001C is calculated at 2.17% at June 30, 2005

For General Revenue Bonds, Series 2001B and 2001C, interest rates change weekly

This schedule also includes the debt service requirements for debt associated with interest rate swaps.

More detailed information about interest rate swaps is presented in Note 8C.

F. Bond Defeasance – The University has extinguished long-term debt obligations by the issuance of new long-term debt instruments as follows:

Dining System: On February 7, 2001, the University defeased \$13,205,000 of outstanding Dining System Revenue Bonds, Series 1997. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2005, the outstanding balance of the defeased Dining System bonds was \$10,395,000.

Dormitory System: On December 1, 1999, the University defeased \$1,225,000 of outstanding Dormitory System Revenue Bonds, Series E, F & G (1963). Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2005, the outstanding balance was \$77,000 for the defeased outstanding Dormitory System Revenue Bonds, Series G (1963).

Student Union: On December 1, 1999, the University defeased \$620,000 of outstanding Student Union Revenue Bonds, Series 1967. Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2005, the outstanding balance was \$250,000 for the defeased outstanding Student Union Revenue Bonds, Series 1967.

G. Notes Payable – The University was indebted for notes payable for the purposes shown in the following table:

| Purpose | Financial Institution | Interest Rate/Ranges | Final Maturity Date | Beginning Balance 7/1/2004 | Draws Made Through 06/30/2005 | Principal Paid Through 06/30/2005 | Principal Outstanding 06/30/2005 |
|----------------------------|-----------------------|----------------------|---------------------|----------------------------|-------------------------------|-----------------------------------|----------------------------------|
| Student Family Housing | Bank of America | 3.74% | 10/01/2005 | \$35,000,000 | \$12,300,000 | \$19,910,255 | \$27,389,745 |
| Rizzo Center | Wachovia Bank | 4.54% | 09/22/2006 | | 5,532,556 | | 5,532,556 |
| Real Property Purchases | Bank of America | 3.74% | 06/30/2007 | | 1,897,168 | 1,300,000 | 597,168 |
| Total Notes Payable | | | | \$35,000,000 | \$19,729,724 | \$21,210,255 | \$33,519,469 |

The UNC-Chapel Hill Foundation, part of the University's reporting entity, has a loan agreement for a Student Family Housing Project with Bank of America, originally in the amount of \$35,000,000. The unsecured loan was refinanced on October 1, 2004, and the commitment was increased to \$47,300,000 to provide additional funding with the maturity date extended to October 1, 2005. The outstanding balance under the credit facility accrues interest at the LIBOR Rate plus 0.40 percent. The University plans to refinance the note with other long-term financing.

The Business School Foundation, part of the University's financial reporting entity, closed a \$20 million unsecured line of credit with Wachovia Bank on September 22, 2004. This credit facility is used to fund the expansion of the Paul J. Rizzo Business Conference Center and will expire on September 22, 2006. Advances under the line of credit accrue interest at the variable rate of the LIBOR Market Index plus 1.20 percent. There is an availability fee due each year on the anniversary date of the line of credit and is calculated as 0.125 percent of the difference between the commitment amount and the average balance outstanding for the year leading up to the anniversary date. The University plans to repay the note with other long-term financing.

The UNC-Chapel Hill Foundation, part of the University's reporting entity, has a line of credit agreement issued by Bank of America, originally in the aggregate principal amount up to \$10,000,000 to finance the costs of projects benefiting the Foundation or the University. The line of credit had a maturity date of June 30, 2005 and was extended until June 30, 2007 and the aggregate principal amount was reduced to \$6,000,000. Advances under the line of credit accrue interest at the variable rate of the LIBOR Market Index plus 0.40 percent. There is an unused commitment fee due each quarter calculated as 0.25 percent of the difference between the commitment amount and the average balance outstanding for the quarter through June 30, 2005, and 0.225 percent thereafter. The University repays draws on the note with capital improvement funds designated for land acquisition.

Note 9: Lease Obligations

A. Capital Lease Obligations – Capital lease obligations relating to medical and research equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2005:

| Fiscal Year | Amount |
|---|------------------|
| 2006 | \$626,324 |
| 2007 | 190,567 |
| 2008 | 126,784 |
| 2009 | 82,587 |
| Total Minimum Lease Payments | 1,026,262 |
| Discount Amount Representing Interest (2.5% – 7.3% Rate of Interest) | 56,614 |
| Present Value of Future Lease Payments | \$969,648 |

Machinery and equipment acquired under capital lease amounted to \$1,276,501 at June 30, 2005.

B. Operating Lease Obligations – Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2005:

| Fiscal Year | Amount |
|-------------------------------------|---------------------|
| 2006 | \$6,277,638 |
| 2007 | 4,246,287 |
| 2008 | 1,824,434 |
| 2009 | 516,052 |
| 2010 | 370,771 |
| 2011-2015 | 144,124 |
| Total Minimum Lease Payments | \$13,379,306 |

Rental expense for all operating leases during the year was \$11,170,323.

C. Other Lease Obligations – The UNC-Chapel Hill Foundation issued certificates of participation to provide for construction of alumni facilities. The University constructed the facilities as an agent for the UNC-Chapel Hill Foundation. In October 1989, the University entered into a 20-year lease agreement with the UNC-Chapel Hill Foundation and simultaneously entered into a sublease agreement with the General Alumni Association, an affiliated organization, for the same time period for the use of the alumni facilities.

Payments under the terms of the lease are a limited obligation of the University, payable solely from and secured by the annual rental income derived from the sublease of the alumni facilities. The University has no other obligations for repayment of the certificates of participation; therefore, the certificates are not reported as a liability in the accompanying financial statements. As of June 30, 2005, the aggregate principal amount of the certificates was \$9,950,000.

If the University complies with all the terms of the lease agreement, title to the alumni facilities will be conveyed to the University.

Note 10: Revenues

A summary of eliminations and allowances by revenue classification and revenues pledged as security for revenue bonds is presented as follows:

| | Gross Revenues | Internal Sales Eliminations | Less Scholarship Discounts | Less Change In Allowance for Uncollectibles | Less Indigent Care and Contractual Adjustments | Net Revenues | Revenues Pledged as Security for Debt |
|---|----------------------|-----------------------------|----------------------------|---|--|----------------------|---------------------------------------|
| Operating Revenues: | | | | | | | |
| Student Tuition and Fees | \$202,361,925 | | \$37,905,000 | | | \$164,456,925 | |
| Patient Services | \$414,396,346 | | | (\$747,766) | \$243,081,333 | \$172,062,779 | |
| Sales and Services: | | | | | | | |
| Sales and Services of Auxiliary Enterprises: | | | | | | | |
| Residential Life | \$29,588,016 | | \$5,460,309 | | | \$24,127,707 | \$23,399,623(A) |
| Dining | 20,172,899 | \$73,595 | 372,438 | | | 19,726,866 | |
| Student Union Services | 2,336,654 | | 466,757 | | | 1,869,897 | |
| Health, Physical Education, and Recreation Services | 15,355,964 | | 3,665,191 | | | 11,690,773 | 11,690,773(B) |
| Bookstore | 32,026,077 | 4,953,411 | 153,378 | | | 26,919,288 | |
| Parking | 15,732,201 | | | | | 15,732,201 | 15,732,201(C) |
| Athletic | 37,449,537 | 22,788 | 500,230 | | | 36,926,519 | |
| Utilities | 73,796,128 | 55,654,424 | | | | 18,141,704 | 18,141,704(D) |
| Other Professional Income | 75,461,969 | 515 | | | | 75,461,454 | |
| Other | 155,137,342 | 95,336,585 | | | | 59,800,757 | 5,017,374(E) |
| Total Sales and Services | \$457,056,787 | \$156,041,318 | \$10,618,303 | \$0 | \$0 | \$290,397,166 | \$73,981,675 |
| Non-operating - Non-capital Gifts | \$73,781,228 | | | \$88,431 | | \$73,692,797 | |

Revenue Bonds Secured by Pledged Revenues:

(A) Housing System Revenue Bonds, Series 1997 A & B

(D) Utility System Revenue Bonds, Series 1997

(B) Student Fee Revenue Bonds, Series 1997 & 2000

(E) US EPA Project, Series 1991 & 1996

(C) Parking System Revenue Bonds, Series 1997 A & B

Note 11: Operating Expenses by Function

The University's operating expenses by functional classification are presented as follows:

| | Salaries and Benefits | Supplies and Materials | Services | Scholarships and Fellowships | Utilities | Depreciation | Total |
|-------------------------------------|-----------------------|------------------------|----------------------|------------------------------|---------------------|---------------------|------------------------|
| Instruction | \$432,210,248 | \$27,014,411 | \$116,691,390 | | \$35,023 | | \$575,951,072 |
| Research | 174,936,422 | 39,202,525 | 57,017,134 | | 52,075 | | 271,208,156 |
| Public Service | 29,707,783 | 1,487,165 | 51,743,889 | | 65,846 | | 83,004,683 |
| Academic Support | 50,896,198 | 10,981,672 | 13,505,543 | | 806 | | 75,384,219 |
| Student Services | 10,484,335 | 738,132 | 10,430,121 | | 127 | | 21,652,715 |
| Institutional Support | 45,009,823 | 5,187,601 | 17,195,753 | | 32,750 | | 67,425,927 |
| Operations and Maintenance of Plant | 31,880,071 | 5,635,343 | 14,540,820 | | 40,804,011 | | 92,860,245 |
| Student Financial Aid | | | | \$51,169,976 | | | 51,169,976 |
| Auxiliary Enterprises | 191,504,372 | 58,193,143 | 126,564,746 | | 6,879,532 | | 383,141,793 |
| Depreciation | | | | | | \$60,101,910 | 60,101,910 |
| Total Operating Expenses | \$966,629,252 | \$148,439,992 | \$407,689,396 | \$51,169,976 | \$47,870,170 | \$60,101,910 | \$1,681,900,696 |

Note 12: Pension Plans

A. Retirement Plans – Each permanent full-time employee, as a condition of employment, is a member of either the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Eligible employees can elect to participate in the Optional Retirement Program at the time of employment, otherwise they are automatically enrolled in the Teachers' and State Employees' Retirement System.

The Teachers' and State Employees' Retirement System is a cost sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by the North Carolina State Treasurer.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2005, these rates were set at 2.17 percent of covered payroll for employers and 6 percent of covered payroll for members.

For the year ended June 30, 2005, the University had a total payroll of \$846,607,921, of which \$351,795,628 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$21,107,738 and \$7,633,965, respectively. The University made 100 percent of its annual required contributions for the years ended June 30, 2005, 2004, and 2003, which were \$7,633,965, \$757,757, and \$0, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.state.nc.us/> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of the University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products. The Board has authorized the following carriers: Teachers' Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF), Lincoln Life Insurance Company, Variable Annuity Life Insurance Company (VALIC), and Fidelity Investments. Participants may elect to allocate their contributions and the University contribu-

tions to the carrier of their choice. Each carrier offers a variety of investment funds, including both fixed and variable account investment options and mutual funds.

Participants in the Program are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the Program. Participants become eligible to receive distributions when they terminate employment or retire.

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2005, these rates were set at 6.84 percent of covered payroll for employers and 6 percent of covered payroll for members. The University assumes no liability other than its contribution.

For the year ended June 30, 2005, the University had a total payroll of \$846,607,921, of which \$328,301,666 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$19,698,100 and \$22,455,834, respectively.

B. Deferred Compensation and Supplemental Retirement Income Plans – IRC Section 457 Plan – The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the plan. The board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, the *North Carolina Public Employee Deferred Compensation Trust Fund*. The board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the plan are the responsibility of the plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$4,484,869 for the year ended June 30, 2005.

IRC Section 401(k) Plan – All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the plan are the responsibility of the plan participants. No costs are incurred by the University except for a 5 percent employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2005, were \$98,798. The voluntary contributions by employees amounted to \$2,849,161 for the year ended June 30, 2005.

IRC Section 403(b) and 403(b)(7) Plans – Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other non-profit institutions. All costs of administering and funding these plans are the responsibility of the plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$21,956,103 for the year ended June 30, 2005.

Note 13: Other Postemployment Benefits

A. Health Care for Long-Term Disability Beneficiaries and Retirees – The University participates in state-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.2 percent of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2005, the University's total contribution to the Plan was \$21,763,113. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.

B. Long-Term Disability – The University participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The University contributes 0.445 percent of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. For the year ended June 30, 2005, the University's total contribution to the DIPNC was \$3,026,433. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

Note 14: Risk Management

The University is exposed to various risks of loss related to torts;

theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in state-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

Public Officer's and Employee's Liability Insurance – Tort claims of up to \$500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the state provides excess public officers' and employees' liability insurance up to \$5,000,000 via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

Fire and Other Property Loss – The University is required to maintain fire and lightning coverage on all state-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the state. Such coverage is provided at no cost to operations supported by the state's General Fund. Other operations not supported by the state's General Fund are charged for the coverage. Losses covered by the fund are subject to a \$500 per occurrence deductible. The University also purchased through the fund extended coverage or all risk coverage with a \$500 per occurrence deductible for certain buildings and contents.

Automobile Liability Insurance – All state-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses occurring in-state are \$500,000 per claim and \$5,000,000 per occurrence and out-of-state are \$1,000,000 per claim and \$5,000,000 per occurrence. The University pays premiums to the North Carolina Department of Insurance for the coverage.

Employee and Computer Fraud – The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence with a \$50,000 deductible and a 10 percent participation in each loss above the deductible.

Other authorized coverage not handled by the North Carolina Department of Insurance is purchased through the state's insurance agent of record. Examples include, but are not limited to, fine arts, boiler and machinery, medical professional liability, athletic accident and revenues and study abroad health insurance.

Comprehensive Major Medical Plan – University employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a pension and other employee benefit trust fund of the State of North Carolina. The Plan has contracted with third parties to process claims.

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the state and its component units are included in the program. When an employee is injured, the University's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The University is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act. The University is self-insured for workers' compensation.

Liability Insurance Trust Fund - The University participates in the Liability Insurance Trust Fund (Trust Fund), a claims-serving public entity risk pool for healthcare professional liability protection. The Trust Fund services professional liability claims, managing separate accounts for each participant from which the losses of that participant are paid. Although participant assessments are determined on an actuarial basis, ultimate liability for claims remains with the participants and, accordingly, the insurance risks are not transferred to the Trust Fund.

The Trust Fund was created by Chapter 116, Article 26, of the General Statutes and The University of North Carolina Board of Governors Resolution of June 9, 1978, to provide professional liability protection for program participants and individual health care practitioners working as employees, agents, or officers of The University of North Carolina Hospitals at Chapel Hill (the UNC Hospitals) and The University of North Carolina at Chapel Hill Physicians and Associates (UNC P&A). The Trust Fund is exempt from federal and state income taxes, and is not subject to regulation by the North Carolina Department of Insurance.

Participation in the Trust Fund is open to the University of North Carolina, any constituent institution of the University of North Carolina, the UNC Hospitals, and any health-care institution, agency or entity that has an affiliation agreement with the University of North Carolina, with a constituent institution of the University of North Carolina, or with the UNC Hospitals. Only the UNC P&A and the UNC Hospitals have participated in the Trust Fund to date. Participants provide management and administrative services to the Trust Fund at no cost.

The Trust Fund is governed by the Liability Insurance Trust Fund Council (the Council). The Council consists of 13 members as follows: one member each appointed by the State Attorney General, the State Auditor, the State Insurance Commissioner, the Director of the Office of State Budget and Management, the State Treasurer, (each serving at the pleasure of the appointer); and eight members appointed to three year terms (with no limit on the number of terms) by the UNC System's Board of Governors.

The Trust Fund establishes claim liabilities based on estimates of the ultimate cost of claims (including future expenses and claim adjustment expenses) that have been reported but not settled and of claims incurred but not reported. Claim liabilities are recomputed annually based on an independent actuary's study to produce current estimates that reflect recent settlements, claims frequency, inflation and other factors. Participant assessments

are determined at a level to fund claim liabilities, discounted for future investment earnings. Each participant is required by statute to maintain a fund balance of \$100,000 at all times. Participants are subject to additional premium assessments in the event of deficiencies.

The Trust Fund provides coverage for participants as a corporate entity, as well as for the employees and professional staff of the participants. From July 1, 2004 through June 30, 2005, the Trust Fund provided coverage on an occurrence basis of \$3,000,000 per individual and \$7,000,000 in the aggregate per claim. Effective July 1, 2004 through June 30, 2005, the Trust Fund entered into an excess of loss agreement with an unaffiliated reinsurer. Reinsurance coverage under this policy carries a \$10,000,000 aggregate limit in excess of a self-insured aggregate of \$30,000,000 subject to a \$7,000,000 per occurrence limit (sub-limit of \$3,000,000 per individual) with a \$300,000 continuing underlying amount per claim. For fiscal year ending June 30, 2005, the Trust Fund purchased a direct insurance policy to cover the first \$1,000,000 per occurrence and \$3,000,000 in the aggregate for dental residents. The Trust Fund provides coverage of \$500,000 per occurrence in accordance with the limited waiver of sovereign immunity afforded by the State Tort Claims Act, for any recovery against the participants for the negligence of its employees. To assure that both existing and future claims will be paid, the UNC System Board of Governors is authorized by law to borrow up to \$30,000,000 to replenish the Trust Fund. No borrowings have been made under this line of credit to date. The Council believes adequate funds are on deposit in the Trust Fund to meet estimated losses based upon the results of the independent actuary's report.

The Trust Fund has purchased annuity contracts to settle claims for which the claimant has signed an agreement releasing the Fund from further obligation. The related claim liabilities have been removed from estimated malpractice costs. The likelihood that the Trust Fund will be required to make future payments on these claims is considered remote.

The Council may choose to terminate the Trust Fund, or the respective participants may choose to terminate their participation. In the event of such termination by either the Council or a participant, an updated actuarial study will be performed to determine amounts due to or from the participants based on loss experience up to the date of termination.

At June 30, 2005, University assets in the Trust Fund totaled \$32,811,589 while University liabilities totaled \$26,585,628 resulting in net assets of \$6,225,961.

Additional disclosures relative to the funding status and obligations of the Trust Fund are set forth in the Audited Financial Statements of the Liability Insurance Trust Fund for the years ended June 30, 2005 and 2004. Copies of this report may be obtained from The University of North Carolina Liability Insurance Trust Fund, 6001 East Wing, University of North Carolina Hospitals, 101 Manning Drive, Chapel Hill, North Carolina 27514, or by calling (919) 966-3041.

Term Life Insurance – Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. There were no employer contributions required for the current fiscal year.

Additional details on the State-administered risk management programs are disclosed in the State's *Comprehensive Annual Financial Report*, issued by the Office of the State Controller.

Note 15: Commitments and Contingencies

A. Commitments – The University has commitments of \$65,771,751 for various capital improvements projects that include construction and completion of new buildings, and renovations of existing buildings.

B. Pending Litigation and Claims – A \$2.1 million claim related to the construction of the Frank Porter Graham Student Union project has been submitted to the State Construction Office by the contractor. No ruling has been made regarding this claim.

The Supreme Court of North Carolina issued a ruling on July 1, 2005 regarding litigation between North Carolina School Boards Association, et. al. v. Richard H. Moore, State Treasurer, et. al. which involves various state officials in their official capacity seeking a judicial determination as to whether the state constitution requires certain monetary payments collected by state agencies to be paid to the local county school funds rather than statutorily designated recipients. The complaint alleged in part that the monetary payments collected pursuant to statutory authority by the University for violations of parking and traffic regulations and library fines are “civil penalties” which the State Constitution requires to be paid to the school fund in the county where they are collected. The lawsuit sought declaratory judgment that the State Civil Penalty and Forfeiture Fund, the State School Technology Fund, and the Public Settlement Reserve Fund are unconstitutional. On December 14, 2001, the Wake County Superior Court ruled in favor of the plaintiffs but has stayed enforcement of the ruling, pending appeal. The defendants did appeal this judgment. The Court of Appeals affirmed in part and reversed in part the order of summary judgment by

the Superior Court. The Supreme Court affirmed the Court of Appeals ruling that library fines are not civil penalties. The Supreme Court reversed the ruling that fines for parking and traffic regulations are not civil penalties. The Supreme Court ruling is under review to determine the financial impact on parking and traffic operations. At issue is the effective date of the ruling. The amount of \$11,101,663 representing fines from the Public Safety department has been collected from 1994–95 through 2004–05, and of that amount 20 percent may be retained by the University to fund related operating expenses. Therefore, \$8,881,330 may be payable by the University. The amount of \$3,907,525 has been held in reserve to fund the required payment. Annual fines are approximately \$1,000,000. It is not expected that the effective date of the ruling will be prior to fiscal year 1994–95.

The University is undertaking environmental remediation efforts on the Old Sanitary Landfill. The amount of the liability associated with this site cannot reasonably be estimated at this time.

The University is a party to other litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.

C. University Improvement General Obligation Bonds

– The 1999–2000 Session of the General Assembly of North Carolina authorized the issuance of \$2.5 billion of general obligation bonds of the state, as subsequently approved by a vote of qualified voters of the state, to provide funds for capital improvements for the University of North Carolina. The funds authorized are to be used solely for capital facilities cost on the University of North Carolina campuses as specified in the legislation. The bond legislation specifies the amount of bond funding for each University campus and the level of bond funding intended for each project. The bonds are authorized to be issued over a six-year period beginning in 2001 at a level not to exceed amounts provided in the legislation. Using a cash flow financing approach, The University of North Carolina – General Administration (UNC-GA), establishes annual amounts not to exceed for each approved project. The amounts not to exceed are subject

to change due to actual cash availability and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, UNC-GA notifies the Office of State Budget and Management (OSBM) of the amounts not to exceed for each approved project. Within these amounts, based on an official request of cash needs from the University, OSBM authorizes allotments. The University records the allotments as revenue on the accompanying financial statements. The University's remaining authorization of \$164,052,183 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

D. Other Contingent Receivables – The University has received notification of other gifts and grants for which funds have not been disbursed by the resource provider and for which conditions attached to the gift or grant have not been satisfied or, in the case of permanent endowments, cannot begin to be satisfied. In accordance with accounting principles generally accepted in the United States of America, these amounts have not been recorded on the accompanying financial statements. The purpose and amount of other contingent receivables at year-end is as follows:

| Purpose | Amount |
|---------------------------------|--------------|
| Pledges to permanent endowments | \$44,144,921 |

Note 16: Related Parties

Foundations – Separately incorporated non-profit foundations associated with the University are The Botanical Garden Foundation, Inc., The Dental Alumni Association, Inc., The Dental Foundation of North Carolina, Inc., The Educational Foundation, Inc., The General Alumni Association, The Institute of Government Foundation, Inc., The Law Alumni Association of N.C., Inc., The Morehead Scholarship Foundation, Inc. The Pharmacy Foundation of North Carolina, Inc., The School of Education Foundation, Inc., The School of Journalism and Mass Communication Foundation of North Carolina, Inc., The University of North Carolina at Chapel Hill Public Health Foundation, Inc., and The University of North Carolina at Chapel Hill School of

Nursing Foundation, Inc.

These organizations serve, in conjunction with the University's component units (See Note 1A), as the primary fund-raising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. The alumni associations provide educational opportunities or other services to alumni. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of the foundations, except for support from each organization to the University. This support totaled approximately \$10,598,810 for the year ended June 30, 2005.

Note 17: Change in Financial Accounting and Reporting

For the fiscal year ended June 30, 2005, the University implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*. This Statement establishes and modifies disclosure requirements related to investment risks: credit risk, interest rate risk, and foreign currency risk. This statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk and foreign currency risk.

Note 18: Subsequent Events

On August 30, 2005, the University issued \$404,960,000 of University of North Carolina at Chapel Hill General Revenue and Revenue Refunding Bonds, Series 2005A. The 2005A Bonds were issued to provide funds (1) to finance or refinance the costs of certain capital projects at the University of North Carolina at Chapel Hill, (2) to advance refund certain revenue bonds issued for the benefit of the University, (3) to pay capitalized interest on a portion of the 2005A Bonds and (4) to pay the costs incurred in connection with the issuance of the 2005A Bonds. The bonds will mature, subject to mandatory and optional redemption, from December 1, 2005 to December 1, 2034, with amounts varying from \$480,000 due December 1, 2005 to \$305,680,000 Term Bonds due December 1, 2034. The 2005A bonds have an interest rate range of 3 percent to 5 percent.



STATISTICAL SECTION

Carolina graduates turn their tassels at Commencement at Kenan Stadium.

STATISTICAL SECTION NOTE

Effective July 1, 2001, the University implemented GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – For Public Colleges and Universities*. The financial statement presentation required by these Statements is a single-column enterprise activity rather than the fund-group perspective previously reported. Significant accounting changes in order to comply with the new requirements include adopting depreciation on capital assets, reporting revenues net of discounts and allowances, eliminating inter-fund activities, classifying activities as operating or non-operating, classifying assets and liabilities as current or non-current, and prorating summer school activities to periods earned.

In addition, the University implemented GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. Changes in existing disclosures include more detailed information on debt service requirements, obligations under leases, and short-term debt. New disclosures include variable debt interest information and the major components of receivable and payable balances.

For the fiscal year ended June 30, 2004, the University implemented GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*. This Statement amends GASB Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance to determine whether certain organizations for which the University is not financially accountable should be reported as component units based on the nature and significance of their relationship to the University.

Due to these significant changes in financial reporting, the University is presenting only four years of data in this statistical section, except for specific revenue and general revenue bond coverage and demographic data which are not affected by the GASB implementation. For informational purposes, selected ten years of statistical data (Fiscal years 1992 – 2001) are included in the “Historical Statistical Section,” reproduced from the 2001 CAFR.

OPERATING AND NON-OPERATING REVENUES BY SOURCE

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|--------------------------------------|------------------------|------------------------|------------------------|------------------------|
| Operating Revenues | | | | |
| Student Tuition and Fees, net | \$164,456,925 | \$153,943,215 | \$146,961,417 | \$124,661,145 |
| Federal Grants and Contracts | 403,099,819 | 384,617,775 | 356,845,158 | 330,402,676 |
| State and Local Grants and Contracts | 39,816,204 | 39,793,048 | 34,288,762 | 38,512,136 |
| Nongovernmental Grants and Contracts | 81,560,319 | 75,387,855 | 64,546,516 | 75,536,237 |
| Patient Services, net | 172,062,779 | 172,877,025 | 131,256,051 | 137,035,225 |
| Sales and Services, net | 290,397,166 | 270,350,638 | 262,105,915 | 246,567,989 |
| Interest Earnings on Loans | 1,440,909 | 434,974 | 281,215 | 120,650 |
| Other Operating Revenues | 4,167,246 | 5,232,791 | 7,282,755 | 14,628,956 |
| Total Operating Revenues | 1,157,001,367 | 1,102,637,321 | 1,003,567,789 | 967,465,014 |
| Non-operating Revenues | | | | |
| State Appropriations | 406,672,962 | 380,446,327 | 368,024,036 | 368,504,553 |
| Non-capital Grants, net | 62,544,341 | 53,153,741 | 40,994,829 | 34,768,925 |
| Non-capital Gifts, net | 73,692,797 | 68,517,192 | 60,887,596 | 62,403,802 |
| Investment Income, net | 154,899,571 | 135,369,198 | 47,398,174 | 52,956,614 |
| Total Non-operating Revenues | 697,809,671 | 637,486,458 | 517,304,635 | 518,633,894 |
| Total Revenues | \$1,854,811,038 | \$1,740,123,779 | \$1,520,872,424 | \$1,486,098,908 |

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|--------------------------------------|---------------|---------------|---------------|---------------|
| Operating Revenues | | | | |
| Student Tuition and Fees, net | 8.9% | 8.9% | 9.7% | 8.4% |
| Federal Grants and Contracts | 21.7% | 22.1% | 23.5% | 22.2% |
| State and Local Grants and Contracts | 2.1% | 2.3% | 2.3% | 2.6% |
| Nongovernmental Grants and Contracts | 4.4% | 4.3% | 4.2% | 5.1% |
| Patient Services, net | 9.3% | 9.9% | 8.6% | 9.2% |
| Sales and Services, net | 15.7% | 15.5% | 17.2% | 16.6% |
| Interest Earnings on Loans | 0.1% | 0.0% | 0.0% | 0.0% |
| Other Operating Revenues | 0.2% | 0.3% | 0.5% | 1.0% |
| Total Operating Revenues | 62.4% | 63.3% | 66.0% | 65.1% |
| Non-operating Revenues | | | | |
| State Appropriations | 21.9% | 21.9% | 24.2% | 24.8% |
| Non-capital Grants, net | 3.4% | 3.1% | 2.7% | 2.3% |
| Non-capital Gifts, net | 4.0% | 3.9% | 4.0% | 4.2% |
| Investment Income, net | 8.3% | 7.8% | 3.1% | 3.6% |
| Total Non-operating Revenues | 37.6% | 36.7% | 34.0% | 34.9% |
| Total Revenues | 100.0% | 100.0% | 100.0% | 100.0% |

(Percent of total revenues)

OPERATING AND NON-OPERATING EXPENSES BY NATURE

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|---|------------------------|------------------------|------------------------|------------------------|
| Operating Expenses | | | | |
| Salaries and Benefits | \$966,629,252 | \$917,840,235 | \$876,265,477 | \$829,473,249 |
| Supplies and Materials | 148,439,992 | 151,196,308 | 146,986,272 | 148,324,265 |
| Services | 407,689,396 | 380,125,640 | 377,855,970 | 364,831,514 |
| Scholarships and Fellowships | 51,169,976 | 47,427,018 | 45,618,092 | 40,414,555 |
| Utilities | 47,870,170 | 46,207,389 | 43,914,948 | 45,452,167 |
| Depreciation | 60,101,910 | 60,589,122 | 53,075,830 | 48,517,249 |
| Total Operating Expenses by Nature | 1,681,900,696 | 1,603,385,712 | 1,543,716,589 | 1,477,012,999 |
| Non-operating Expenses | | | | |
| Interest and Fees on Debt | 21,822,928 | 18,339,114 | 15,680,788 | 15,031,104 |
| Other Non-operating Expenses | 2,635,416 | 8,132,036 | 1,899,072 | 7,661,489 |
| Total Non-operating Expenses | 24,458,344 | 26,471,150 | 17,579,860 | 22,692,593 |
| Total Expenses | \$1,706,359,040 | \$1,629,856,862 | \$1,561,296,449 | \$1,499,705,592 |

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|---|---------------|---------------|---------------|---------------|
| Operating Expenses | | | | |
| Salaries and Benefits | 56.7% | 56.3% | 56.1% | 55.3% |
| Supplies and Materials | 8.7% | 9.3% | 9.4% | 9.9% |
| Services | 23.9% | 23.3% | 24.2% | 24.3% |
| Scholarships and Fellowships | 3.0% | 2.9% | 2.9% | 2.7% |
| Utilities | 2.8% | 2.9% | 2.8% | 3.0% |
| Depreciation | 3.5% | 3.7% | 3.5% | 3.3% |
| Total Operating Expenses by Nature | 98.6% | 98.4% | 98.9% | 98.5% |
| Non-operating Expenses | | | | |
| Interest and Fees on Debt | 1.2% | 1.1% | 1.0% | 1.0% |
| Other Non-operating Expenses | 0.2% | 0.5% | 0.1% | 0.5% |
| Total Non-operating Expenses | 1.4% | 1.6% | 1.1% | 1.5% |
| Total Expenses | 100.0% | 100.0% | 100.0% | 100.0% |

(Percent of total operating expenses by nature)

★ See graph on page 79

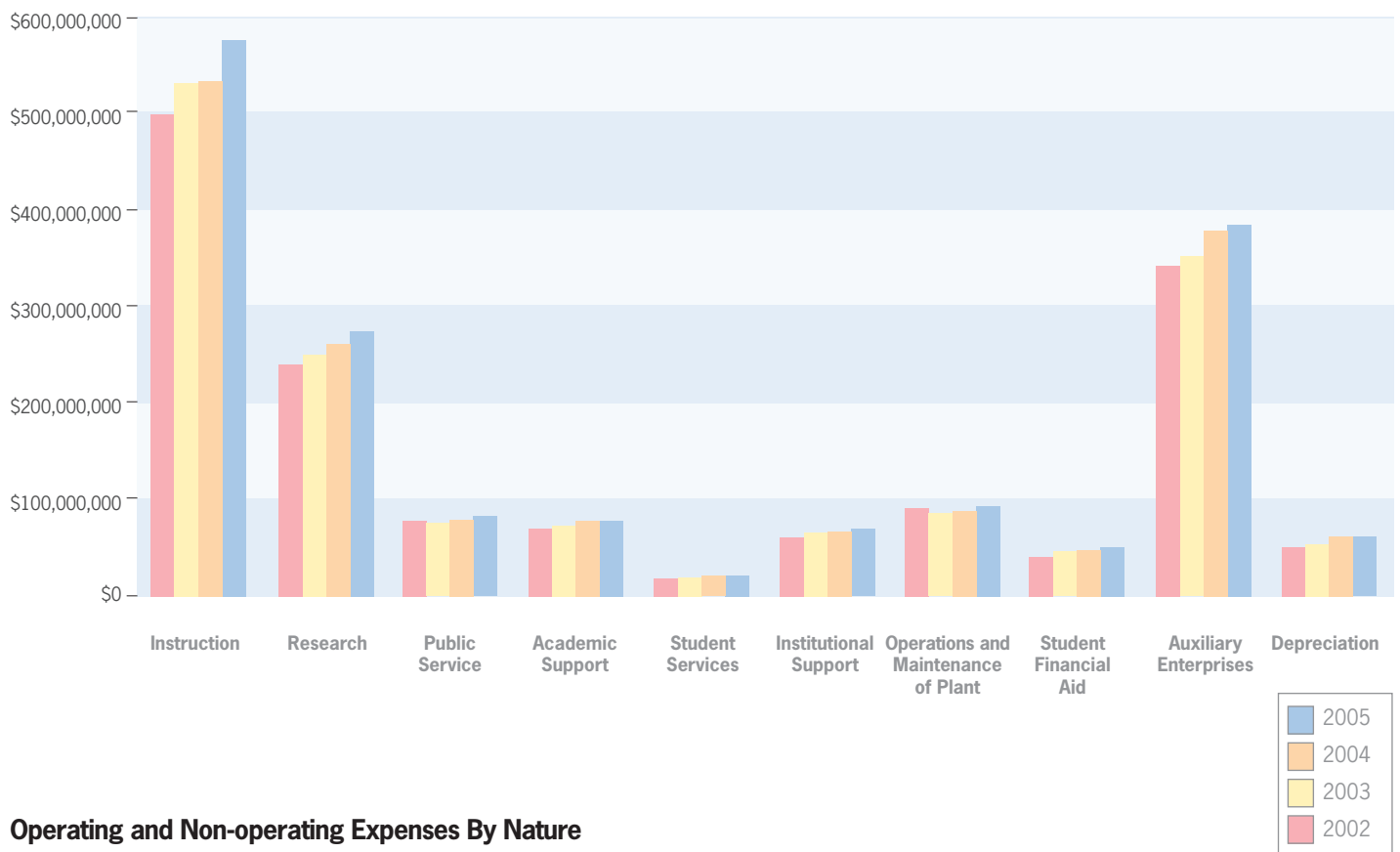
OPERATING AND NON-OPERATING EXPENSES BY FUNCTION

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|---|------------------------|------------------------|------------------------|------------------------|
| Operating Expenses by Function | | | | |
| Instruction | \$575,951,072 | \$532,927,326 | \$531,123,250 | \$497,770,880 |
| Research | 271,208,156 | 257,945,228 | 247,434,086 | 237,275,464 |
| Public Service | 83,004,683 | 78,275,601 | 75,409,910 | 76,896,238 |
| Academic Support | 75,384,219 | 75,692,980 | 70,888,224 | 67,617,814 |
| Student Services | 21,652,715 | 20,487,890 | 19,490,735 | 18,224,875 |
| Institutional Support | 67,425,927 | 64,731,371 | 63,460,504 | 58,560,098 |
| Operations and Maintenance of Plant | 92,860,245 | 87,890,864 | 86,451,422 | 90,941,785 |
| Student Financial Aid | 51,169,976 | 47,427,018 | 45,618,092 | 40,414,555 |
| Auxiliary Enterprises | 383,141,793 | 377,418,312 | 350,764,536 | 340,794,041 |
| Depreciation | 60,101,910 | 60,589,122 | 53,075,830 | 48,517,249 |
| Total Operating Expenses by Function | 1,681,900,696 | 1,603,385,712 | 1,543,716,589 | 1,477,012,999 |
| Non-operating Expenses | | | | |
| Interest and Fees on Debt | 21,822,928 | 18,339,114 | 15,680,788 | 15,031,104 |
| Other Non-operating Expenses | 2,635,416 | 8,132,036 | 1,899,072 | 7,661,489 |
| Total Non-operating Expenses | 24,458,344 | 26,471,150 | 17,579,860 | 22,692,593 |
| Total Expenses | \$1,706,359,040 | \$1,629,856,862 | \$1,561,296,449 | \$1,499,705,592 |

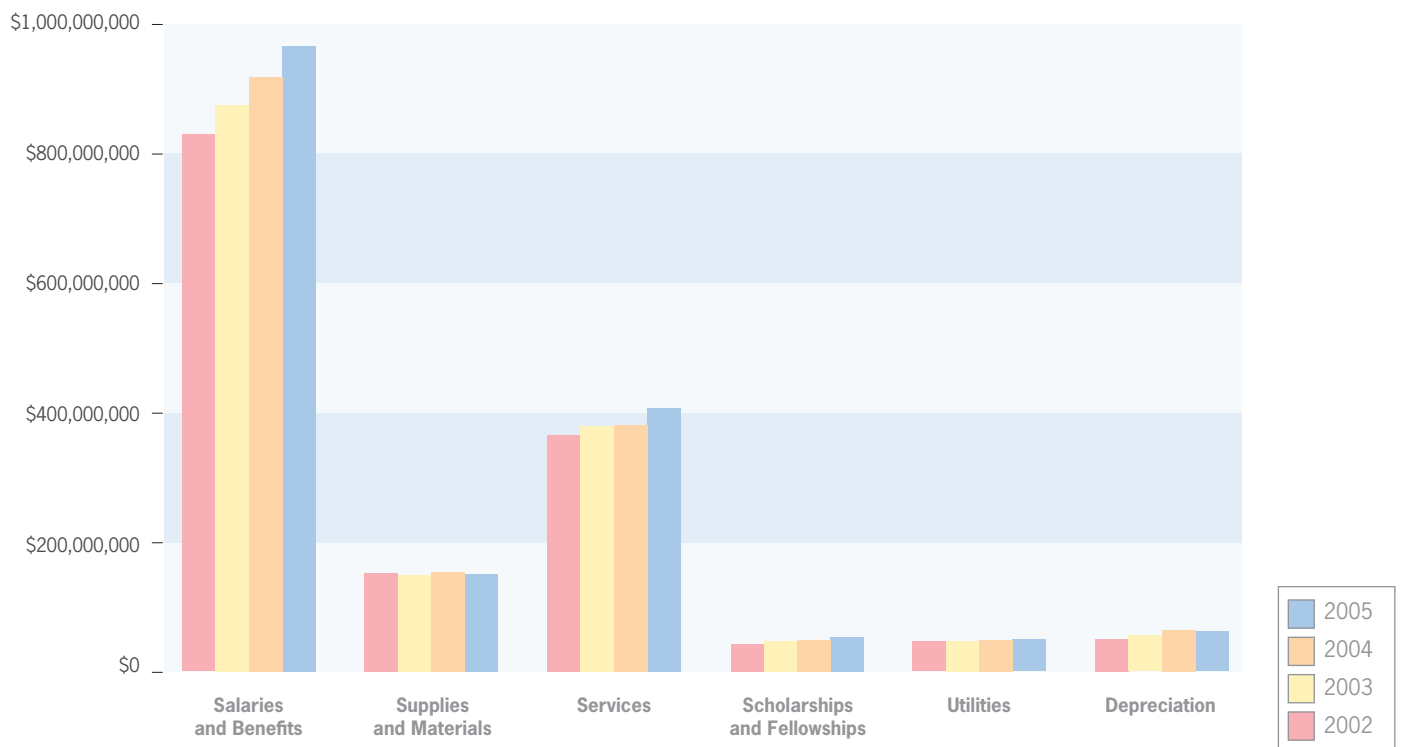
| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|---|---------------|---------------|---------------|---------------|
| Operating Expenses by Function | | | | |
| Instruction | 33.8% | 32.7% | 34.0% | 33.2% |
| Research | 15.9% | 15.8% | 15.9% | 15.8% |
| Public Service | 4.9% | 4.8% | 4.8% | 5.1% |
| Academic Support | 4.4% | 4.6% | 4.5% | 4.5% |
| Student Services | 1.3% | 1.3% | 1.3% | 1.2% |
| Institutional Support | 4.0% | 4.0% | 4.1% | 3.9% |
| Operations and Maintenance of Plant | 5.4% | 5.4% | 5.5% | 6.1% |
| Student Financial Aid | 3.0% | 2.9% | 2.9% | 2.7% |
| Auxiliary Enterprises | 22.4% | 23.2% | 22.5% | 22.7% |
| Depreciation | 3.5% | 3.7% | 3.4% | 3.2% |
| Total Operating Expenses by Function | 98.6% | 98.4% | 98.9% | 98.5% |
| Non-operating Expenses | | | | |
| Interest and Fees on Debt | 1.2% | 1.1% | 1.0% | 1.0% |
| Other Non-operating Expenses | 0.2% | 0.5% | 0.1% | 0.5% |
| Total Non-operating Expenses | 1.4% | 1.6% | 1.1% | 1.5% |
| Total Expenses | 100.0% | 100.0% | 100.0% | 100.0% |

(Percent of total operating expenses by nature)

Operating and Non-operating Expenses By Function



Operating and Non-operating Expenses By Nature



SUMMARY OF RATIOS

COMPOSITE FINANCIAL INDEX

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|----------------------------------|-------------|-------------|-------------|-------------|
| + Primary Reserve Ratio | 0.71 x | 0.65 x | 0.60 x | 0.66 x |
| / Strength Factor | 0.133 | 0.133 | 0.133 | 0.133 |
| * Weighting Factor | 35% | 35% | 35% | 35% |
| + Return on Net Assets Ratio | 16.4% | 10.7% | 3.1% | 2.4% |
| / Strength Factor | 2.00% | 2.00% | 2.00% | 2.00% |
| * Weighting Factor | 20% | 20% | 20% | 20% |
| + Net Operating Revenues Ratio | 8.6% | 6.3% | -2.7% | -0.9% |
| / Strength Factor | 0.70% | 0.70% | 0.70% | 0.70% |
| * Weighting Factor | 10% | 10% | 10% | 10% |
| + Viability Ratio | 2.5 x | 2.1 x | 2.3 x | 2.6 x |
| / Strength Factor | 0.417 | 0.417 | 0.417 | 0.417 |
| * Weighting Factor | 35% | 35% | 35% | 35% |
| Composite Financial Index | 6.81 | 5.43 | 3.39 | 4.23 |

The Composite Financial Index (CFI) provides a methodology for a single overall financial measurement of the institution's health based on the four core ratios. The CFI uses a reasonable weighting plan and allows a weakness or strength in a specific ratio to be offset by another ratio result, which provides a more balanced measure. The FI provides a more holistic approach to understanding the financial health of the institution. The CFI scores are not intended to be precise measures; they are indicators of ranges of financial health that can be indicators of overall institutional well-being when combined with non-financial indicators.

PRIMARY RESERVE RATIO

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|---|-----------------|-----------------|-----------------|-----------------|
| Unrestricted net assets | \$475,630,812 | \$408,704,774 | \$370,815,821 | \$346,545,802 |
| Expendable restricted net assets | 736,631,596 | 648,019,434 | 559,127,937 | 645,389,715 |
| Expendable net assets | \$1,212,262,408 | \$1,056,724,208 | \$929,943,758 | \$991,935,517 |
| Operating expenses | \$1,681,900,696 | \$1,603,385,712 | \$1,543,716,589 | \$1,477,012,999 |
| Interest and fees on capital asset-related debt | 21,822,928 | 18,339,114 | 15,680,788 | 15,031,104 |
| Total expenses | \$1,703,723,624 | \$1,621,724,826 | \$1,559,397,377 | \$1,492,044,103 |
| Expendable net assets | \$1,212,262,408 | \$1,056,724,208 | \$929,943,758 | \$991,935,517 |
| Total expenses | \$1,703,723,624 | \$1,621,724,826 | \$1,559,397,377 | \$1,492,044,103 |
| Ratio | 0.71 x | 0.65 x | 0.60 x | 0.66 x |

Measures the financial strength of the institution by indicating how long the institution could function using its expendable reserves to cover operations should additional net assets not be available. A positive ratio and an increasing amount over time denotes strength.

SUMMARY OF RATIOS (CONTINUED)

RETURN ON NET ASSETS RATIO

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|--------------------------------------|-----------------|-----------------|-----------------|-----------------|
| Change in Net assets | \$366,680,106 | \$216,013,557 | \$60,767,554 | \$45,393,586 |
| Total Net Assets (beginning of year) | \$2,241,199,157 | \$2,025,185,600 | \$1,964,418,046 | \$1,919,024,460 |
| Ratio | 16.4% | 10.7% | 3.1% | 2.4% |

Measures total economic return. While a increasing trend reflects strength, a decline may be appropriate and even warranted if it represents a strategy on the part of the institution to fulfill its mission.

NET OPERATING REVENUES RATIO

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|---|-----------------|-----------------|-----------------|-----------------|
| Total Operating Revenues | \$1,157,001,367 | \$1,102,637,321 | \$1,003,567,789 | \$967,465,014 |
| State Appropriations | 406,672,962 | 380,446,327 | 368,024,036 | 368,504,553 |
| Non-capital Gifts and grants, net | 136,237,138 | 121,670,933 | 101,882,425 | 97,172,727 |
| Investment Income, net | 154,899,571 | 135,369,198 | 47,398,174 | 52,956,614 |
| Adjusted Net Operating Revenues | \$1,854,811,038 | \$1,740,123,779 | \$1,520,872,424 | \$1,486,098,908 |
| Income Before Other Revenues, Expenses, Gains, or Losses | \$159,461,695 | \$110,266,917 | \$(40,424,025) | \$(13,606,684) |
| Adjusted Net Operating Revenues | \$1,854,811,038 | \$1,740,123,779 | \$1,520,872,424 | \$1,486,098,908 |
| Ratio | 8.6% | 6.3% | -2.7% | -0.9% |

Measures whether the institution is living within available resources. A positive ratio and an increasing amount over time, generally reflects strength.

VIABILITY RATIO

| FOR THE YEAR ENDED JUNE 30 | 2005 | 2004 | 2003 | 2002 |
|----------------------------------|-----------------|-----------------|---------------|---------------|
| Unrestricted Net Assets | \$475,630,812 | \$408,704,774 | \$370,815,821 | \$346,545,802 |
| Expendable Restricted Net Assets | 736,631,596 | 648,019,434 | 559,127,937 | 645,389,715 |
| Expendable Net Assets | \$1,212,262,408 | \$1,056,724,208 | \$929,943,758 | \$991,935,517 |
| Bonds | \$456,093,056 | \$471,683,877 | \$373,547,551 | \$383,954,638 |
| Notes | 33,519,469 | 35,000,000 | 39,332,505 | 3,800,229 |
| Notes - Component Units * | 262,791 | 255,343 | n/a | n/a |
| Total Adjusted University Debt | \$489,875,316 | \$506,939,220 | \$412,880,056 | \$387,754,867 |
| Expendable Net Assets | \$1,212,262,408 | \$1,056,724,208 | \$929,943,758 | \$991,935,517 |
| Total Adjusted University Debt | \$489,875,316 | \$506,939,220 | \$412,880,056 | \$387,754,867 |
| Ratio | 2.5 x | 2.1 x | 2.3 x | 2.6 x |

Measures the ability of the institution to cover its debt as of the balance sheet date, should the institution need to do so. A positive ratio of greater than 1:1 generally denotes strength.

SUMMARY OF RATIOS (CONTINUED)

OPERATING MARGIN EXCLUDING GIFTS

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|--|-----------------|-----------------|-----------------|-----------------|
| Income Before Other | | | | |
| Revenues, Expenses, Gains, or Losses | \$159,461,695 | \$110,266,917 | (\$40,424,025) | (\$13,606,684) |
| Less: Noncapital Gifts and Grants, net | (136,237,138) | (121,670,933) | (101,882,425) | (97,172,727) |
| Adjusted Income Before Other | \$23,224,557 | (\$11,404,016) | (\$142,306,450) | (\$110,779,411) |
| Total Operating Revenues | \$1,157,001,367 | \$1,102,637,321 | \$1,003,567,789 | \$967,465,014 |
| State Appropriations | 406,672,962 | 380,446,327 | 368,024,036 | 368,504,553 |
| Investment Income, net | 154,899,571 | 135,369,198 | 47,398,174 | 52,956,614 |
| Adjusted Net Operating Revenues less Gifts | \$1,718,573,900 | \$1,618,452,846 | \$1,418,989,999 | \$1,388,926,181 |
| Adjusted Income Before Other Revenues, Expenses, Gains, or Losses | \$23,224,557 | (\$11,404,016) | (\$142,306,450) | (\$110,779,411) |
| Adjusted Net Operating Revenues less Gifts | \$1,718,573,900 | \$1,618,452,846 | \$1,418,989,999 | \$1,388,926,181 |
| Ratio | 1.4% | -0.7% | -10.0% | -8.0% |

A more restrictive measure of whether the institution is living within available resources. A positive ratio and an increasing amount over time generally reflects strength.

EXPENDABLE RESOURCES TO DEBT

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|--|-----------------|-----------------|---------------|---------------|
| Unrestricted Net Assets | \$475,630,812 | \$408,704,774 | \$370,815,821 | \$346,545,802 |
| Unrestricted Net Assets - Component Units * | 20,653,221 | 17,723,823 | n/a | n/a |
| Expendable Restricted Net Assets | 736,631,596 | 648,019,434 | 559,127,937 | 645,389,715 |
| Temporarily Restricted Net Assets - Component Units * | 238,744,849 | 209,029,695 | n/a | n/a |
| Gross Expendable Net Assets | \$1,471,660,478 | \$1,283,477,726 | \$929,943,758 | \$991,935,517 |
| Total Bonds | \$456,093,056 | \$471,683,877 | \$373,547,551 | \$383,954,638 |
| Less: U.S. EPA Project Bonds ** | 27,317,385 | (29,221,070) | (30,975,153) | (32,590,965) |
| Total Adjusted University Debt | \$428,775,671 | \$442,462,807 | \$342,572,398 | \$351,363,673 |
| Gross Expendable Net Assets | \$1,471,660,478 | \$1,283,477,726 | \$929,943,758 | \$991,935,517 |
| Total Adjusted University Debt | \$428,775,671 | \$442,462,807 | \$342,572,398 | \$351,363,673 |
| Ratio | 3.4 x | 2.9 x | 2.7 x | 2.8 x |

A broader measure of the ability of the institution to cover its debt as of the balance sheet date.

* For the fiscal year ended June 30, 2004, the University implemented Governmental Accounting Standards Board Statement No. 39, Determining Whether Certain Organizations are Component Units. This Statement amends GASB Statement No. 14, The Financial Reporting Entity, to provide additional guidance to determine whether certain organizations for which the University is not financially accountable should be reported as component units based on the nature and significance of their relationship to the University. The component units of the University are discretely presented in the Financial Section.

** U.S. EPA Project Bonds are secured by an irrevocable lease from the U.S. government. This lease covers the debt service requirements for the term of the Bonds.

SUMMARY OF RATIOS (CONTINUED)

TOTAL FINANCIAL RESOURCES TO DIRECT DEBT

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|--|-----------------|-----------------|-----------------|-----------------|
| Unrestricted Net Assets | \$475,630,812 | \$408,704,774 | \$370,815,821 | \$346,545,802 |
| Nonexpendable Restricted Net Assets | 378,234,148 | 328,735,341 | 323,961,205 | 304,096,632 |
| Expendable Restricted Net Assets | 736,631,596 | 648,019,434 | 559,127,937 | 645,389,715 |
| Total Financial Resources | \$1,590,496,556 | \$1,385,459,549 | \$1,253,904,963 | \$1,296,032,149 |
| Total Financial Resources | \$1,590,496,556 | \$1,385,459,549 | \$1,253,904,963 | \$1,296,032,149 |
| Total Notes, Bonds, Capital Leases and Commercial Paper | \$631,723,173 | \$516,845,291 | \$432,806,684 | \$389,360,567 |
| Ratio | 2.5 x | 2.7 x | 2.9 x | 3.3 x |

A broader measure of the ability of the institution to cover its debt as of the balance sheet date.

DIRECT DEBT TO ADJUSTED CASH FLOW

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|--|-----------------|-----------------|-----------------|-----------------|
| Net Cash Used by Operating Activities | (\$460,045,805) | (\$348,742,031) | (\$382,265,470) | (\$440,098,807) |
| State Appropriations | 406,672,962 | 380,446,327 | 368,024,036 | 368,504,553 |
| Grants for Other than Capital Purposes | 62,544,341 | 53,153,741 | 40,994,829 | 34,768,925 |
| Non-capital Gifts | 73,692,797 | 68,517,192 | 60,887,596 | 62,403,802 |
| Adjusted Cash Flow from Operations | \$82,864,295 | \$153,375,229 | \$87,640,991 | \$25,578,473 |
| Total Notes, Bonds, Capital Leases and Commercial Paper | \$631,723,173 | \$516,845,291 | \$432,806,684 | \$389,360,567 |
| Adjusted Cash Flow from Operations | \$82,864,295 | \$153,375,229 | \$87,640,991 | \$25,578,473 |
| Ratio | 7.6 x | 3.4 x | 4.9 x | 15.2 x |

Measures the financial strength of the institution by indicating how long the institution would take to repay the debt using the cash provided by its operations. A decreasing ratio over time denotes strength.

SUMMARY OF RATIOS (CONTINUED)

DEBT BURDEN RATIO

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|---|-----------------|-----------------|-----------------|-----------------|
| Interest and Fees Paid on Capital Debt and Leases | \$22,644,190 | \$20,438,400 | \$18,302,926 | \$21,117,301 |
| Principal Paid on Capital Debt and Leases | 39,607,649 | 21,900,068 | 14,044,252 | 14,130,000 |
| Less: Principal Paid from Refinancing Activities | (19,910,255) | (4,332,505) | | |
| Debt Service | \$42,341,584 | \$38,005,963 | \$32,347,178 | \$35,247,301 |
| Operating Expenses | \$1,681,900,696 | \$1,603,385,712 | \$1,543,716,589 | \$1,477,012,999 |
| Interest and Fees on Capital Asset-related Debt | 21,822,928 | 18,339,114 | 15,680,788 | 15,031,104 |
| Other Nonoperating Revenues (Expenses) | 2,635,416 | 8,132,036 | 1,899,072 | 7,661,489 |
| Less: Depreciation Expense | (60,101,910) | (60,589,122) | (53,075,830) | (48,517,249) |
| Plus: Principal Paid on Capital Debt and Leases | 39,607,649 | 21,900,068 | 14,044,252 | 14,130,000 |
| Less: Principal Paid from Refinancing Activities | (19,910,255) | (4,332,505) | | |
| Total Expenditures | \$1,665,954,524 | \$1,591,167,808 | \$1,522,264,871 | \$1,465,318,343 |
| Debt Service | \$42,341,584 | \$38,005,963 | \$32,347,178 | \$35,247,301 |
| Total Expenditures | \$1,665,954,524 | \$1,586,835,303 | \$1,522,264,871 | \$1,465,318,343 |
| Ratio | 2.5% | 2.4% | 2.1% | 2.4% |

Measures the financial strength of the institution by indicating how long the institution could function using its expendable reserves to cover operations should additional net assets not be available. A positive ratio and an increasing amount over time denotes strength.

DEBT SERVICE TO OPERATIONS

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|---|-----------------|-----------------|-----------------|-----------------|
| Interest and Fees Paid on Capital Debt and Leases | \$22,644,190 | \$20,438,400 | \$18,302,926 | \$21,117,301 |
| Less: Interest and Fees Paid - U.S. EPA Project Bonds * | (1,520,112) | (1,767,646) | (1,994,832) | (2,197,937) |
| Principal Paid on Capital Debt and Leases | 39,607,649 | 21,900,068 | 14,044,252 | 14,130,000 |
| Less: Principal Paid from Refinancing Activities | (19,910,255) | (4,332,505) | | |
| Less: Principal Paid - U.S. EPA Project Bonds * | (3,065,000) | (2,815,000) | (2,585,000) | (2,385,000) |
| Debt Service | \$37,756,472 | \$33,423,317 | \$27,767,346 | \$30,664,364 |
| Debt Service | \$37,756,472 | \$33,423,317 | \$27,767,346 | \$30,664,364 |
| Operating Expenses | \$1,681,900,696 | \$1,603,385,712 | \$1,543,716,589 | \$1,477,012,999 |
| Ratio | 2.2% | 2.1% | 1.8% | 2.1% |

Measures the financial strength of the institution.

* U.S. EPA Project Bonds are secured by an irrevocable lease from the U.S. government. This lease covers the debt service requirements for the term of the Bonds.

SUMMARY OF RATIOS (CONTINUED)

RESEARCH EXPENSES TO TOTAL OPERATING EXPENSES

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|---|-----------------|-----------------|-----------------|-----------------|
| Operating Expenses | \$1,681,900,696 | \$1,603,385,712 | \$1,543,716,589 | \$1,477,012,999 |
| Interest and Fees on Capital Asset-related Debt | 21,822,928 | 18,339,114 | 15,680,788 | 15,031,104 |
| Other Non-operating (Revenues) Expenses | 2,635,416 | 8,132,036 | 1,899,072 | 7,661,489 |
| Total Adjusted Operating Expenses | \$1,706,359,040 | \$1,629,856,862 | \$1,561,296,449 | \$1,499,705,592 |
| Research Expenses | \$271,208,156 | \$257,945,228 | \$247,434,086 | \$237,275,464 |
| Total Adjusted Operating Expenses | \$1,706,359,040 | \$1,629,856,862 | \$1,561,296,449 | \$1,499,705,592 |
| Ratio | 15.9% | 15.8% | 15.8% | 15.8% |

Measures the institution's research expense to the total operating expenses.

NET TUITION PER STUDENT

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|--|----------------|----------------|----------------|----------------|
| Student Tuition and Fees, net | \$164,456,925 | \$153,943,215 | \$146,961,417 | \$124,661,145 |
| Less: Scholarships and Fellowships | (51,169,976) | (47,427,018) | (45,618,092) | (40,414,555) |
| Net Tuition and Fees | \$113,286,949 | \$106,516,197 | \$101,343,325 | \$84,246,590 |
| Net Tuition and Fees | \$113,286,949 | \$106,516,197 | \$101,343,325 | \$84,246,590 |
| Undergraduate, Graduate and Professional FTE | 25,043 | 24,314 | 24,041 | 23,517 |
| Net Tuition per Student | \$4,524 | \$4,381 | \$4,215 | \$3,582 |

Measures the institution's net student tuition and fees received per student.

STATE APPROPRIATION PER STUDENT

| FOR THE YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 |
|---|-----------------|-----------------|-----------------|-----------------|
| State Appropriations | \$406,672,962 | \$380,446,327 | \$368,024,036 | \$368,504,553 |
| Undergraduate, Graduate, and Professional FTE | 25,043 | 24,314 | 24,041 | 23,517 |
| State Appropriation per Student | \$16,239 | \$15,647 | \$15,308 | \$15,670 |

Measures institution's dependency on state appropriations.

SPECIFIC REVENUE AND GENERAL REVENUE BOND COVERAGE

TEN FISCAL YEARS

The University of North Carolina at Chapel Hill has issued General Revenue Bonds, which are repaid from Available Funds. Available Funds are defined as any unrestricted Net Assets remaining after satisfying obligations of the University under trust indentures, trust agreements or bond resolutions (Specific Revenue Bonds), but excluding State Appropriations, Tuition, and certain special facilities revenues. Specific Revenue Bonds have a pledged revenue stream as the repayment source.

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---------------|---------------|---------------|---------------|---------------|
| Specific Revenue Bond Coverage | | | | | |
| Gross Operating Revenues | \$125,968 | \$121,470 | \$116,985 | \$102,042 | \$92,977 |
| Direct Operating Expenses | 90,218 | 90,057 | 90,731 | 73,720 | 64,808 |
| Net Revenue Available for Debt Service | 35,750 | 31,413 | 26,254 | 28,322 | 28,169 |
| Principal | 5,700 | 5,335 | 6,420 | 10,090 | 9,195 |
| Interest | 3,669 | 4,034 | 4,414 | 8,433 | 10,203 |
| Specific Revenue Debt Service Requirements | 9,369 | 9,369 | 10,834 | 18,523 | 19,398 |
| Coverage | 3.82 | 3.35 | 2.42 | 1.53 | 1.45 |

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 | 2001 |
|--|--------------------|------------------|------------------|------------------|------------------|
| Available Funds General Revenue Bonds | | | | | |
| Total Unrestricted Revenue | \$1,191,976 | \$1,148,297 | \$1,055,273 | \$987,708 | \$1,009,353 |
| Less: | | | | | |
| State Appropriations | (406,673) | (380,446) | (368,024) | (368,505) | (402,205) |
| Tuition and Fees | (164,457) | (153,943) | (146,961) | (124,661) | (139,319) |
| Specific Revenue Debt Service Requirements | (9,369) | (9,369) | (10,834) | (18,523) | (19,398) |
| Plus: | | | | | |
| Adjusted Beginning Unrestricted Net Assets | 410,110 | 370,816 | 346,546 | 392,613 | 354,936 |
| Total Available Funds | \$1,021,587 | \$975,355 | \$876,000 | \$868,632 | \$803,367 |
| Annual Increase | \$46,232 | \$99,355 | \$7,368 | \$65,265 | \$58,989 |
| % Increase | 4.7% | 11.3% | 0.8% | 8.1% | 7.9% |

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2005 | 2004 | 2003 | 2002 | 2001 |
|--|-----------------|-----------------|-----------------|-----------------|----------------|
| General Revenue Bond Coverage | | | | | |
| Total Available Funds | \$1,021,587 | \$975,355 | \$876,000 | \$868,632 | \$803,367 |
| Principal | 13,220 | 11,745 | 7,150 | 4,060 | 2,840 |
| Interest | 14,459 | 10,017 | 8,332 | 7,094 | 5,012 |
| General Revenue Debt Service Requirements | \$27,679 | \$21,762 | \$15,482 | \$11,154 | \$7,852 |
| Coverage | 36.91 | 44.82 | 56.58 | 77.88 | 102.31 |

General Revenue Bond Debt Service includes debt service for specific revenue bonds refunded or defeased by issuance of general revenue debt during the year of refunding.

(1) For fiscal year ended June 30, 2002, the University implemented GASB Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments as amended by GASB Statement No. 35, Basic financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities. In addition, the University implemented GASB Statement No. 38, Certain Financial Statement Note Disclosures. The definition of available funds has not changed as a result of implementing these GASB Statements.

| | 2000 | 1999 | 1998 | 1997 | 1996 |
|---|---------------|---------------|---------------|---------------|---------------|
| Specific Revenue Bond Coverage | | | | | |
| Gross Operating Revenues | \$250,316 | \$246,610 | \$226,567 | \$228,228 | \$205,387 |
| Direct Operating Expenses | 214,212 | 208,753 | 189,205 | 177,793 | 158,584 |
| Net Revenue Available for Debt Service | 36,104 | 37,857 | 37,362 | 50,435 | 46,803 |
| Principal | 11,601 | 10,128 | 8,913 | 8,279 | 7,743 |
| Interest | 11,351 | 11,008 | 10,634 | 11,063 | 11,610 |
| Specific Revenue Debt Service Requirements | 22,952 | 21,136 | 19,547 | 19,342 | 19,353 |
| Coverage | 1.57 | 1.79 | 1.91 | 2.61 | 2.42 |

| | 2000 | 1999 | 1998 | 1997 | 1996 |
|--|------------------|------------------|------------------|------------------|------------------|
| Available Funds General Revenue Bonds | | | | | |
| Total Unrestricted Revenue | \$924,667 | \$877,492 | \$819,645 | \$776,658 | \$709,447 |
| Less: | | | | | |
| State Appropriations | (383,189) | (382,372) | (352,283) | (331,650) | (308,245) |
| Tuition and Fees | (121,507) | (110,400) | (105,745) | (102,277) | (88,478) |
| Specific Revenue Debt Service Requirements | (22,952) | (21,136) | (19,547) | (19,342) | (19,353) |
| Plus: | | | | | |
| Beginning Unrestricted Net Assets | 347,359 | 310,896 | 300,367 | 251,740 | 225,795 |
| Total Available Funds | \$744,378 | \$674,480 | \$642,437 | \$575,129 | \$519,166 |
| Annual Increase | \$69,898 | \$32,043 | \$67,308 | \$55,963 | \$34,752 |
| % Increase | 10.4% | 5.0% | 11.7% | 10.8% | 7.2% |

| | 2000 | 1999 | 1998 | 1997 | 1996 |
|--|------------|------------|------------|------------|------------|
| General Revenue Bond Coverage | | | | | |
| Total Available Funds | \$744,378 | \$674,480 | \$642,437 | \$575,129 | \$519,166 |
| Principal | | | | | |
| Interest | | | | | |
| General Revenue Debt Service Requirements | n/a | n/a | n/a | n/a | n/a |
| Coverage | | | | | |

(2) As of July 1, 1997, the fund balances of the various funds as previously reported were restated as a result of the University implementing GASB Number 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools. This statement requires that certain investments be reported at fair value for year-end financial reporting purposes.

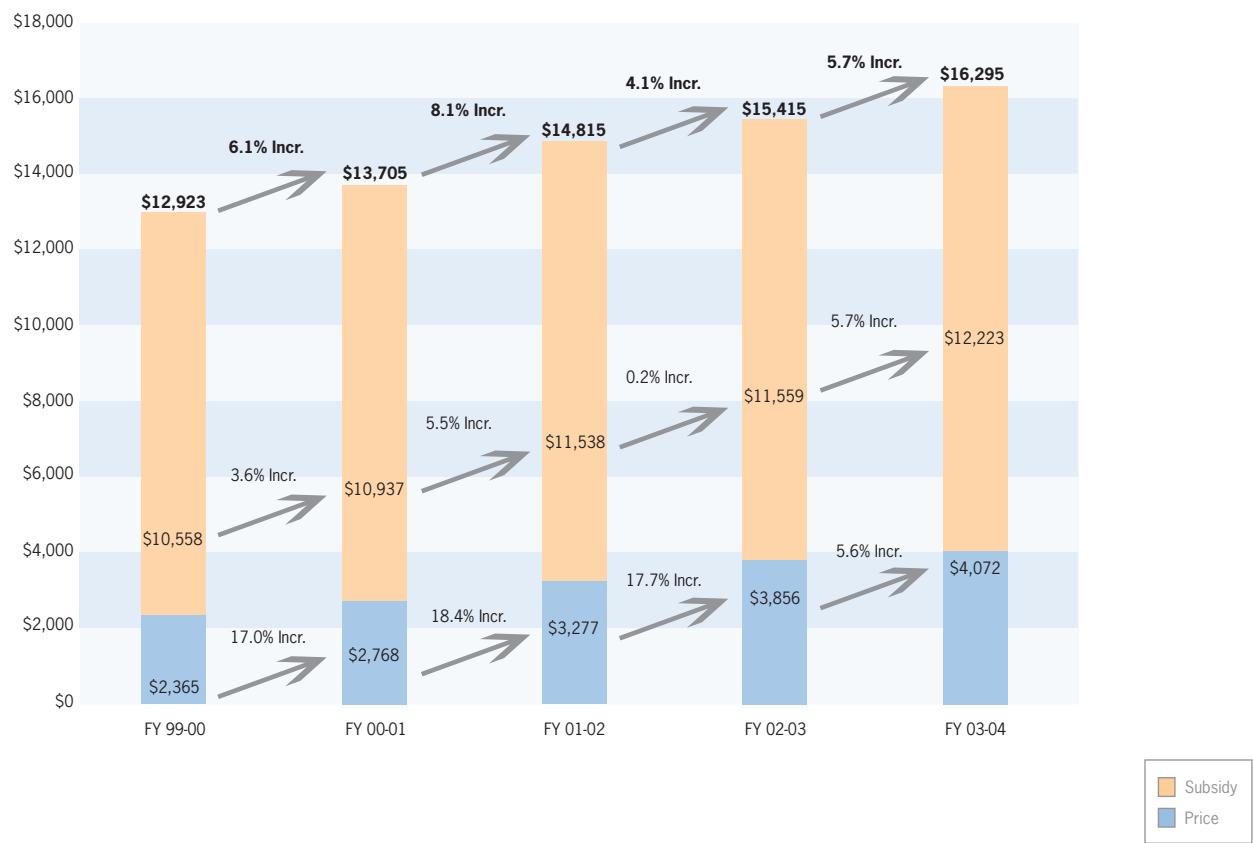
(3) As of July 1, 1993, the fund balances of the various funds as previously reported were restated as a result of the University implementing GASB Number 14, The Financial Reporting Entity. This statement requires that the financial statements of certain affiliated organizations be blended with those of the University.

ANNUAL UNDERGRADUATE EDUCATIONAL COSTS PER STUDENT

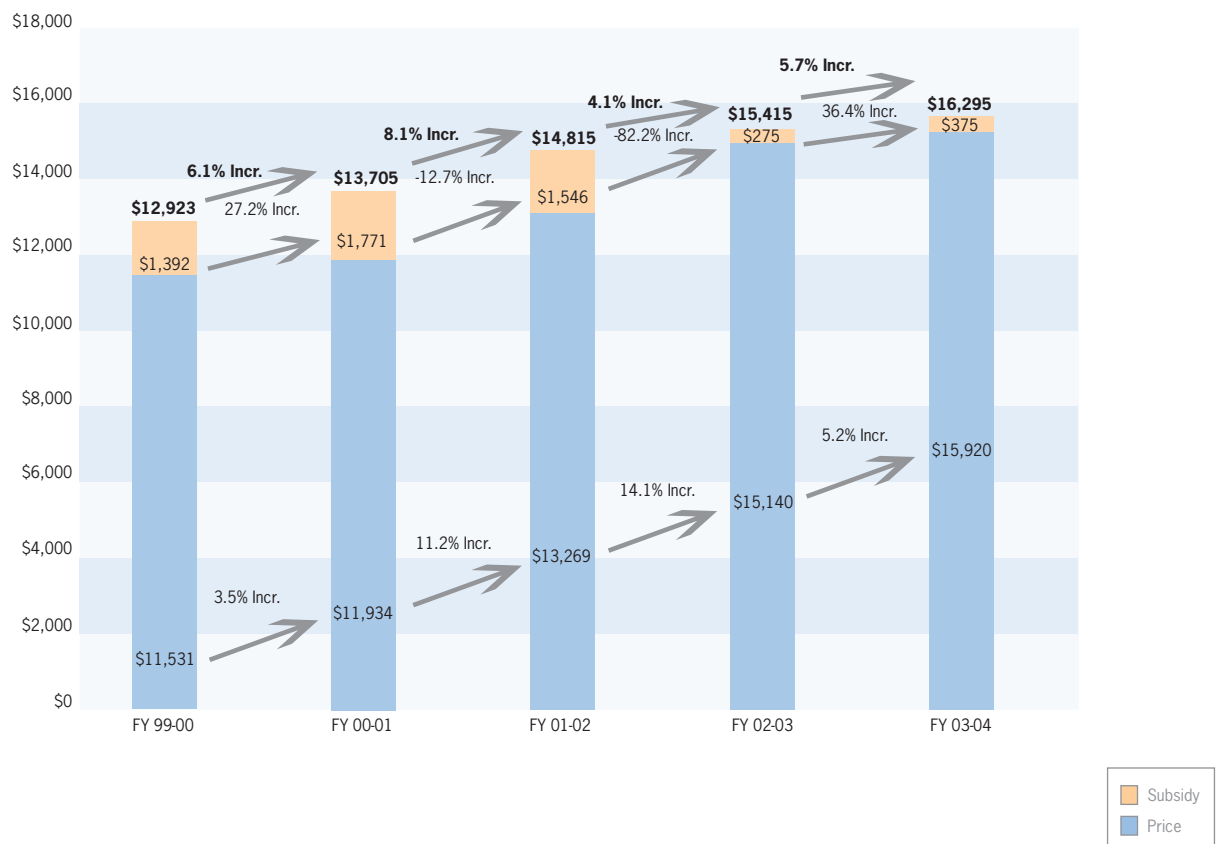
Public concern over tuition prices at colleges and universities led in 1997 to the establishment by Congress of the National Commission on the Cost of Higher Education. The task of the commission was to investigate the college cost-price conundrum and recommend ways to address it. In response, the National Association of College and University Business Officers (NACUBO) developed the Cost of College Project. The goal was to create a uniform methodology that any college or university could use to explain and present how much it costs to provide one year of undergraduate education and related services. The criteria governing the project include: simplicity of use and understanding; basis should be on existing data from annual financial statements; should be applicable to all types of colleges and universities; and should produce reasonable results when compared with more detailed cost data derived from the institution's internal accounting methods.

After more than two years in development and testing by almost 150 colleges and universities, the final project report was delivered in November, 2002. Carolina was one of those testing sites. A single-page template was developed by NACUBO to be used to record the necessary information. The template shows annual costs per resident undergraduate student at the University. The graphs displayed below show historical trends in the total annual costs per resident and non-resident undergraduate student at the University, and the difference between the price the student pays (i.e., tuition and fees) and state support (i.e., "subsidy"). The methodology was created to help individual institutions calculate and report the annual cost of providing an undergraduate education. It was not designed to be a mechanism for collecting national data on college costs or creating industry benchmarks. It is also not a measure of the value or quality of the education provided by the institution.

UNC Chapel Hill's Cost of College Resident Undergraduate Student



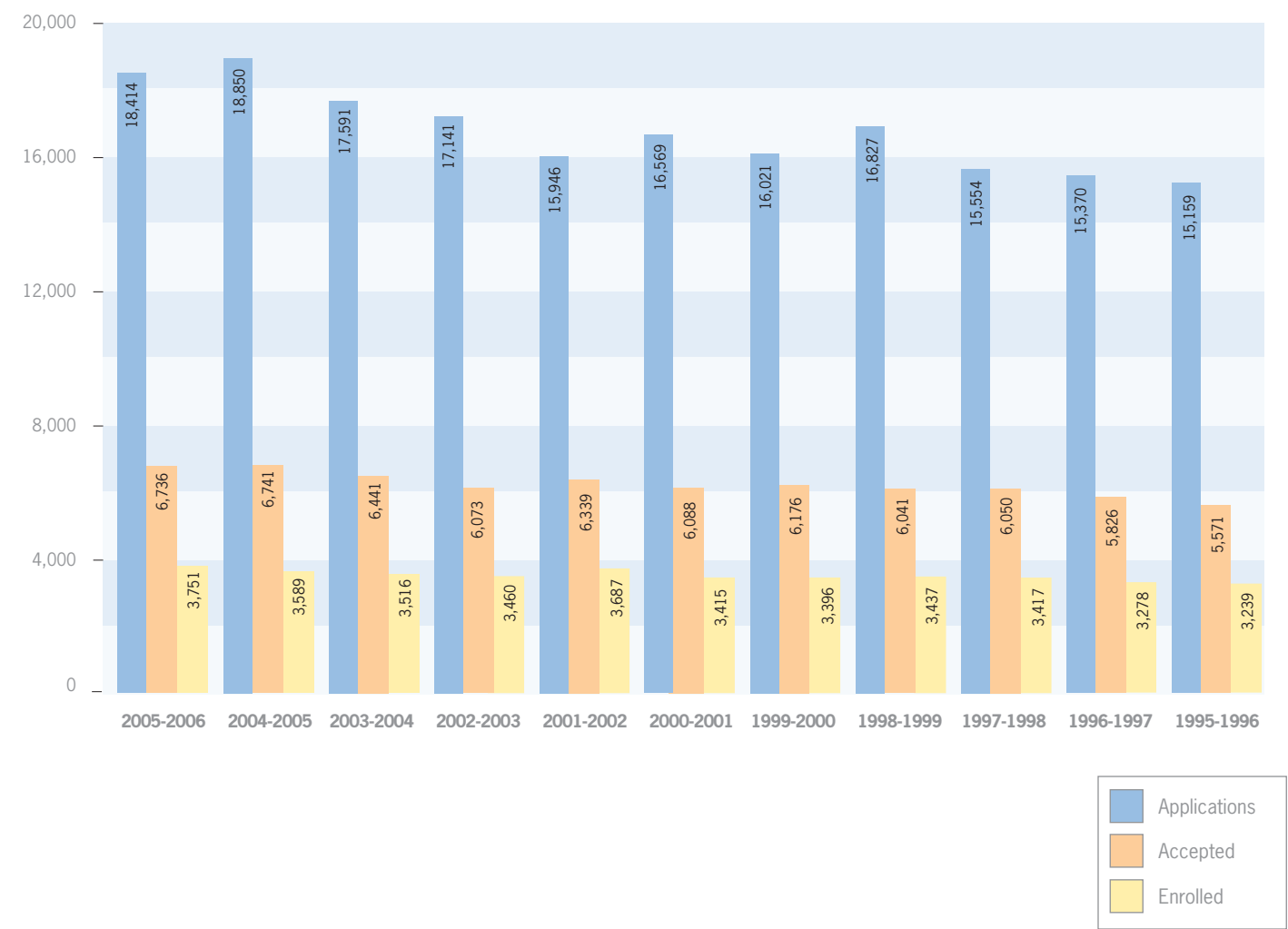
UNC Chapel Hill's Cost of College Non-Resident Undergraduate Student



ADMISSIONS: FALL ENROLLMENT 2005-2006 AND LAST TEN FISCAL YEARS

| | 2005-06 | 2004-05 | 2003-04 | 2002-03 | 2001-02 | 2000-01 | 1999-00 | 1998-99 | 1997-98 | 1996-97 | 1995-96 |
|----------------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Admissions - Freshmen | | | | | | | | | | | |
| Applications | 18,414 | 18,850 | 17,591 | 17,141 | 15,946 | 16,569 | 16,021 | 16,827 | 15,554 | 15,370 | 15,159 |
| Accepted | 6,736 | 6,741 | 6,441 | 6,073 | 6,339 | 6,088 | 6,176 | 6,041 | 6,050 | 5,826 | 5,571 |
| Enrolled | 3,751 | 3,589 | 3,516 | 3,460 | 3,687 | 3,415 | 3,396 | 3,437 | 3,417 | 3,278 | 3,239 |
| Accepted as a | | | | | | | | | | | |
| Percentage of Applications | 36.6% | 35.8% | 36.6% | 35.4% | 39.8% | 36.7% | 38.5% | 35.9% | 38.9% | 37.9% | 36.8% |
| Enrolled as a | | | | | | | | | | | |
| Percentage of Accepted | 55.7% | 53.2% | 54.6% | 57.0% | 58.2% | 56.1% | 55.0% | 56.9% | 56.5% | 56.3% | 58.1% |
| Average SAT Scores - Total | 1,299 | 1,287 | 1,283 | 1,267 | 1,257 | 1,251 | 1,245 | 1,230 | 1,220 | 1,222 | 1,142 |
| Verbal | 643 | 638 | 634 | 625 | 623 | 622 | 620 | 613 | 609 | 611 | 539 |
| Math | 656 | 649 | 649 | 642 | 634 | 629 | 625 | 617 | 611 | 611 | 603 |

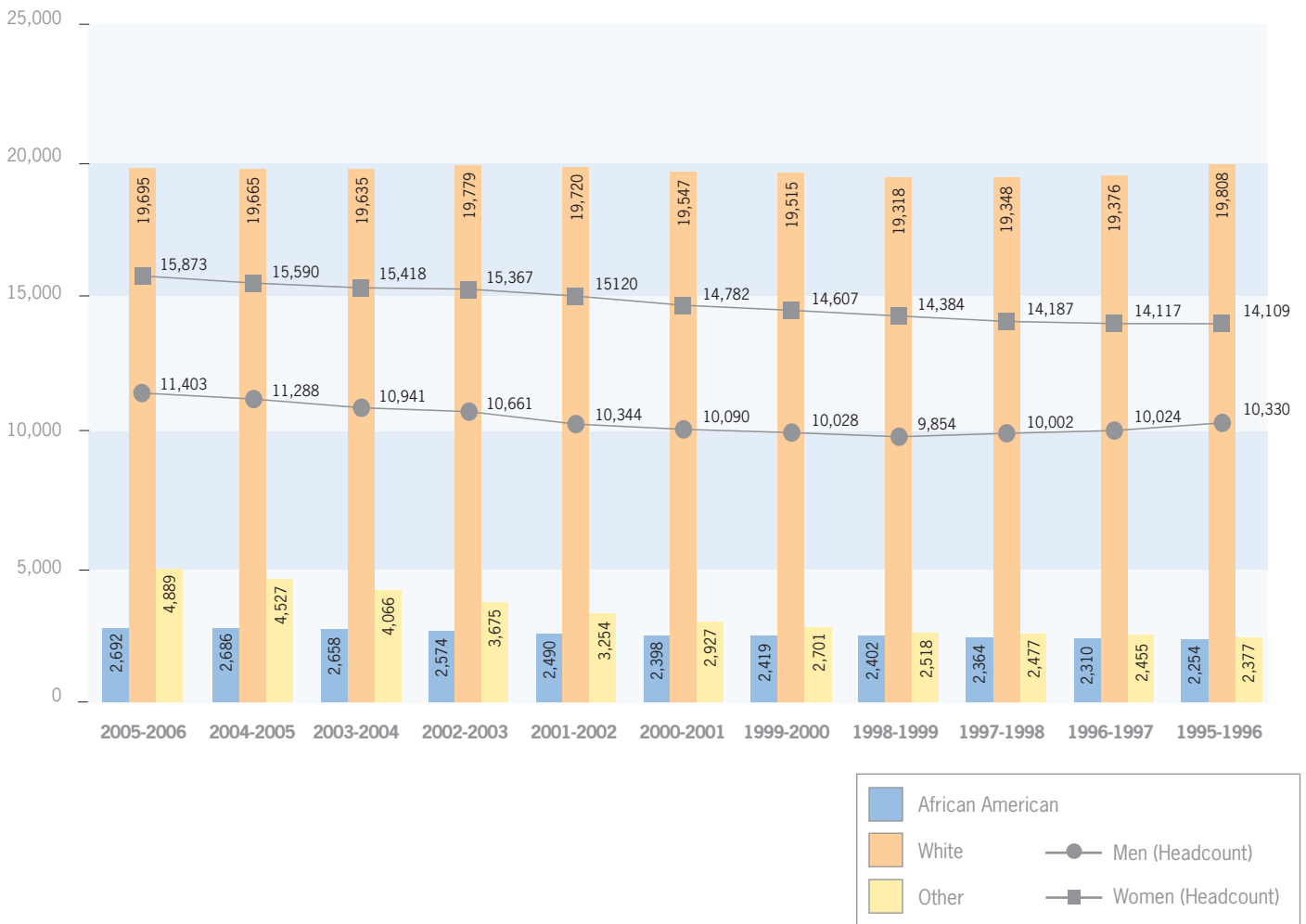
Freshmen Applied, Accepted, and Enrolled



ENROLLMENT: FALL ENROLLMENT 2005-2006 AND LAST TEN FISCAL YEARS

| | 2005-06 | 2004-05 | 2003-04 | 2002-03 | 2001-02 | 2000-01 | 1999-00 | 1998-99 | 1997-98 | 1996-97 | 1995-96 |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Undergraduate, Graduate and Professional FTE | 25,043 | 24,736 | 24,314 | 24,041 | 23,517 | 23,000 | 22,761 | 21,940 | 21,794 | 21,709 | 21,961 |
| Undergraduate, Graduate and Professional Headcount | 27,276 | 26,878 | 26,359 | 26,028 | 25,464 | 24,872 | 24,635 | 24,238 | 24,189 | 24,141 | 24,439 |
| Men (Headcount) | 11,403 | 11,288 | 10,941 | 10,661 | 10,344 | 10,090 | 10,028 | 9,854 | 10,002 | 10,024 | 10,330 |
| Percentage of Total | 41.8% | 42.0% | 41.5% | 41.0% | 40.6% | 40.6% | 40.7% | 40.7% | 41.3% | 41.5% | 42.3% |
| Women (Headcount) | 15,873 | 15,590 | 15,418 | 15,367 | 15,120 | 14,782 | 14,607 | 14,384 | 14,187 | 14,117 | 14,109 |
| Percentage of Total | 58.2% | 58.0% | 58.5% | 59.0% | 59.4% | 59.4% | 59.3% | 59.3% | 58.7% | 58.5% | 57.7% |
| African American (Headcount) | 2,692 | 2,686 | 2,658 | 2,574 | 2,490 | 2,398 | 2,419 | 2,402 | 2,364 | 2,310 | 2,254 |
| Percentage of Total | 9.9% | 10.0% | 10.1% | 9.9% | 9.7% | 9.6% | 9.8% | 9.9% | 9.8% | 9.6% | 9.2% |
| White (Headcount) | 19,695 | 19,665 | 19,635 | 19,779 | 19,720 | 19,547 | 19,515 | 19,318 | 19,348 | 19,376 | 19,808 |
| Percentage of Total | 72.2% | 73.2% | 74.4% | 76.0% | 77.3% | 78.5% | 79.2% | 79.7% | 80.0% | 80.2% | 81.1% |
| Other (Headcount) | 4,889 | 4,527 | 4,066 | 3,675 | 3,254 | 2,927 | 2,701 | 2,518 | 2,477 | 2,455 | 2,377 |
| Percentage of Total | 17.9% | 16.8% | 15.5% | 14.1% | 12.9% | 11.9% | 11.0% | 10.4% | 10.2% | 10.2% | 9.7% |

Headcount Total

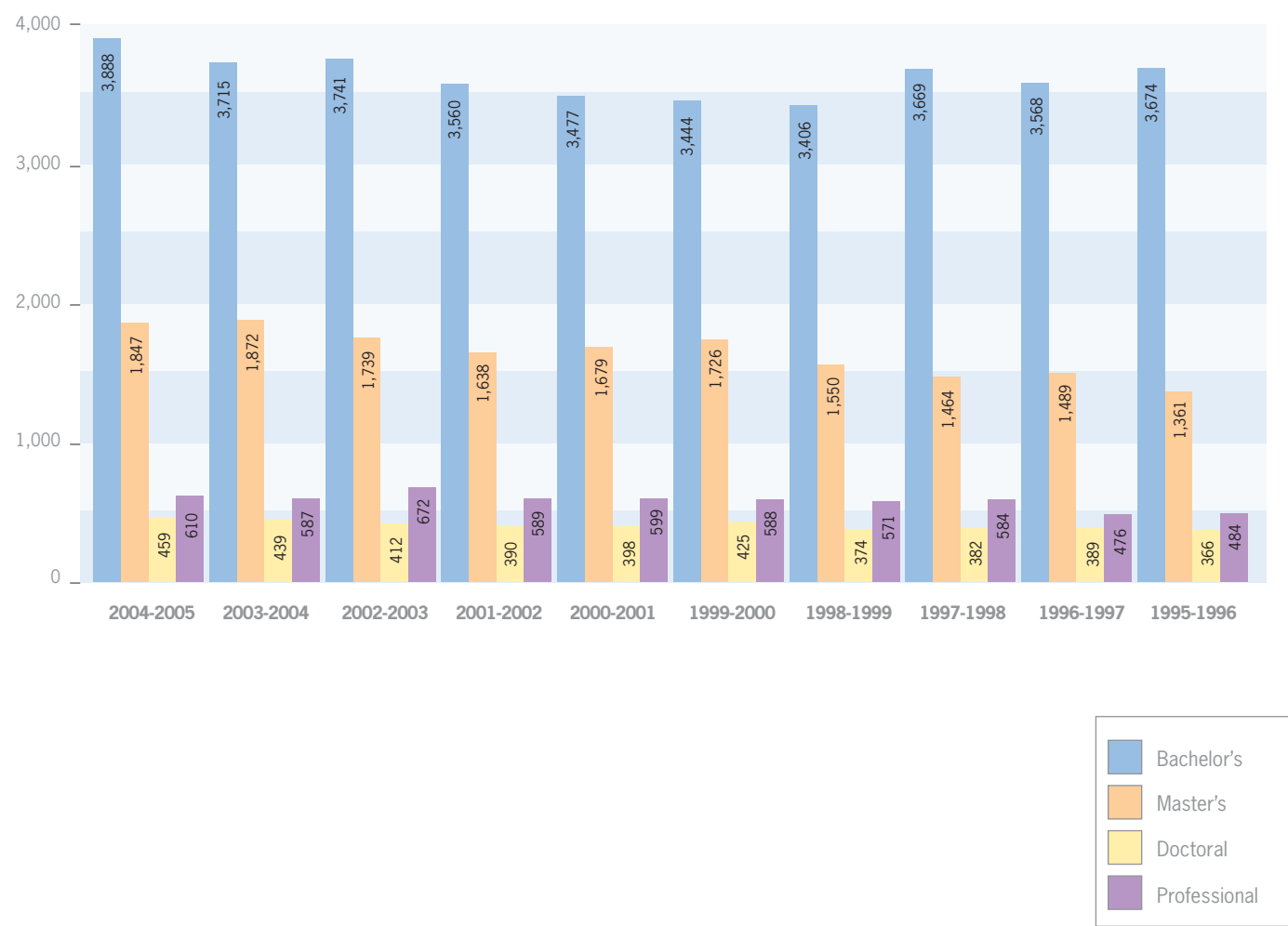


DEGREES EARNED LAST TEN FISCAL YEARS

| | FALL ENROLLMENT OF FISCAL YEAR | | | | | | | | | |
|--------------|--------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| | 2004-05 | 2003-04 | 2002-03 | 2001-02 | 2000-01 | 1999-00 | 1998-99 | 1997-98 | 1996-97 | 1995-96 |
| Bachelor's | 3,888 | 3,715 | 3,741 | 3,560 | 3,477 | 3,444 | 3,406 | 3,669 | 3,568 | 3,674 |
| Master's | 1,847 | 1,872 | 1,739 | 1,638 | 1,679 | 1,726 | 1,550 | 1,464 | 1,489 | 1,361 |
| Doctoral | 459 | 439 | 412 | 390 | 398 | 425 | 374 | 382 | 389 | 366 |
| Professional | 610 | 587 | 672 | 589 | 599 | 588 | 571 | 584 | 476 | 484 |

Source: The University of North Carolina at Chapel Hill Fact Book.

Degrees Earned



FACULTY AND STAFF STATISTICS: FALL EMPLOYMENT AND LAST TEN FISCAL YEARS

| | FALL EMPLOYMENT OF FISCAL YEAR | | | | |
|--|--------------------------------|-----------|-----------|-----------|-----------|
| | 2004-2005 | 2003-2004 | 2002-2003 | 2001-2002 | 2000-2001 |
| Faculty | | | | | |
| Full-time | 2,844 | 2,744 | 2,701 | 2,598 | 2,488 |
| Part-time | 330 | 313 | 307 | 322 | 294 |
| Total Faculty | 3,174 | 3,057 | 3,008 | 2,920 | 2,782 |
| Percentage Tenured | 48.7% | 45.9% | 50.5% | 52.1% | 53.9% |
| Staff and EPA Non-Faculty | | | | | |
| Full-time | 1,307 | 1,227 | 1,157 | 1,034 | 993 |
| Part-time | 132 | 128 | 111 | 97 | 92 |
| EPA Non-Faculty | 1,439 | 1,355 | 1,268 | 1,131 | 1,085 |
| Full-time | 6,004 | 5,947 | 5,915 | 5,782 | 5,574 |
| Part-time | 321 | 317 | 290 | 278 | 284 |
| SPA | 6,325 | 6,264 | 6,205 | 6,060 | 5,858 |
| Total Full-time | 7,311 | 7,174 | 7,072 | 6,816 | 6,567 |
| Total Part-time | 453 | 445 | 401 | 375 | 376 |
| Total Staff and EPA Non-Faculty | 7,764 | 7,619 | 7,473 | 7,191 | 6,943 |

FACULTY AND STAFF STATISTICS: FALL EMPLOYMENT AND LAST TEN FISCAL YEARS (CONTINUED)

FALL EMPLOYMENT OF FISCAL YEAR

| | 1999-2000 | 1998-1999 | 1997-1998 | 1996-1997 | 1995-1996 |
|--|-----------|-----------|-----------|-----------|-----------|
| Faculty | | | | | |
| Full-time | 2,601 | 2,477 | 2,421 | 2,417 | 2,369 |
| Part-time | 260 | 260 | 239 | 223 | 216 |
| Total Faculty | 2,861 | 2,737 | 2,660 | 2,640 | 2,585 |
| Percentage Tenured | 51.9% | 54.6% | 56.2% | 57.9% | 58.3% |
| Staff and EPA Non-Faculty | | | | | |
| Full-time | 784 | 725 | 674 | 653 | 648 |
| Part-time | 63 | 56 | 53 | 56 | 57 |
| EPA Non-Faculty | 847 | 781 | 727 | 709 | 705 |
| Full-time | 5,996 | 5,790 | 5,587 | 5,236 | 5,519 |
| Part-time | 307 | 311 | 314 | 298 | 322 |
| SPA | 6,303 | 6,101 | 5,901 | 5,534 | 5,841 |
| Total Full-time | 6,780 | 6,515 | 6,261 | 5,889 | 6,167 |
| Total Part-time | 370 | 367 | 367 | 354 | 379 |
| Total Staff and EPA Non-Faculty | 7,150 | 6,882 | 6,628 | 6,243 | 6,546 |

Note: SPA denotes employees subject to the State Personnel Act
EPA denotes employees exempt from the State Personnel Act

Source: The University of North Carolina at Chapel Hill Fact Book.



HISTORICAL STATISTICAL SECTION

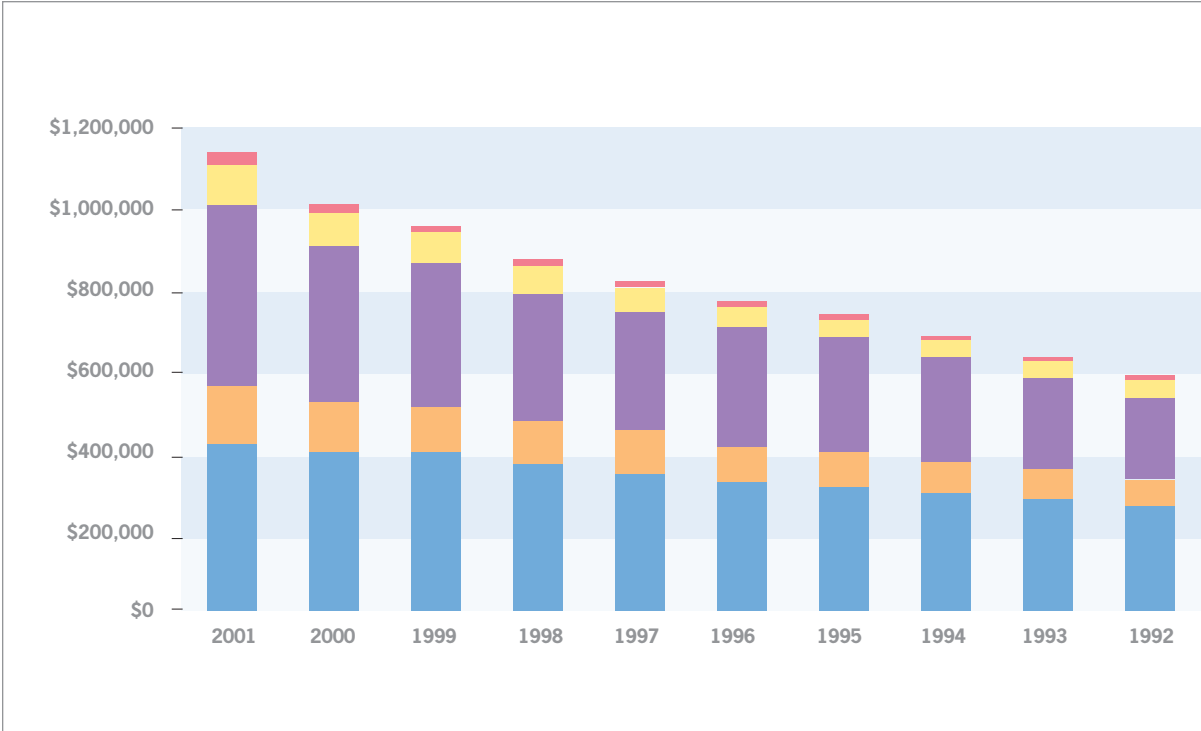
Students walk past the Old Well, Carolina's primary campus landmark.

UNRESTRICTED GENERAL AND RESTRICTED CURRENT FUNDS REVENUES BY SOURCE

TEN FISCAL YEARS

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--|--------------------|------------------|------------------|------------------|------------------|
| Current Funds Revenues | | | | | |
| State Appropriations | \$402,205 | \$383,189 | \$382,372 | \$352,283 | \$331,650 |
| Tuition and Fees | 139,319 | 121,507 | 110,400 | 105,745 | 102,277 |
| Contracts and Grants | 434,683 | 378,094 | 347,850 | 307,685 | 288,042 |
| Gifts, Investment and Endowment Income | 103,382 | 83,459 | 74,557 | 66,321 | 62,720 |
| Sales and Services and Others | 23,347 | 11,797 | 8,767 | 10,816 | 7,317 |
| Total Current Funds Revenues | \$1,102,936 | \$978,046 | \$923,946 | \$842,850 | \$792,006 |



(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--|------------------|------------------|------------------|------------------|------------------|
| Current Funds Revenues | | | | | |
| State Appropriations | \$308,245 | \$302,337 | \$283,826 | \$270,700 | \$255,003 |
| Tuition and Fees | 88,478 | 81,465 | 75,531 | 66,718 | 60,247 |
| Contracts and Grants | 284,195 | 272,176 | 249,448 | 225,512 | 198,095 |
| Gifts, Investment and Endowment Income | 54,486 | 50,429 | 47,637 | 43,783 | 41,676 |
| Sales and Services and Others | 6,693 | 6,043 | 4,646 | 3,066 | 5,310 |
| Total Current Funds Revenues | \$742,097 | \$712,450 | \$661,088 | \$609,779 | \$560,331 |

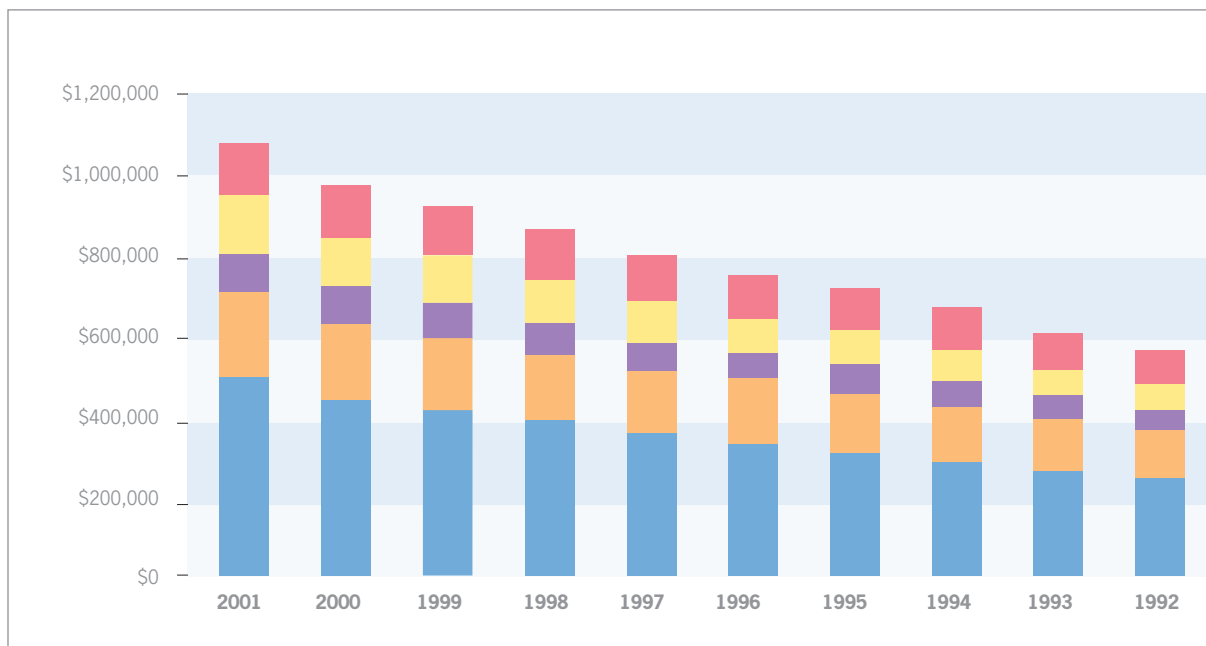


UNRESTRICTED GENERAL AND RESTRICTED CURRENT FUNDS EXPENDITURES AND MANDATORY TRANSFERS BY FUNCTION

TEN FISCAL YEARS

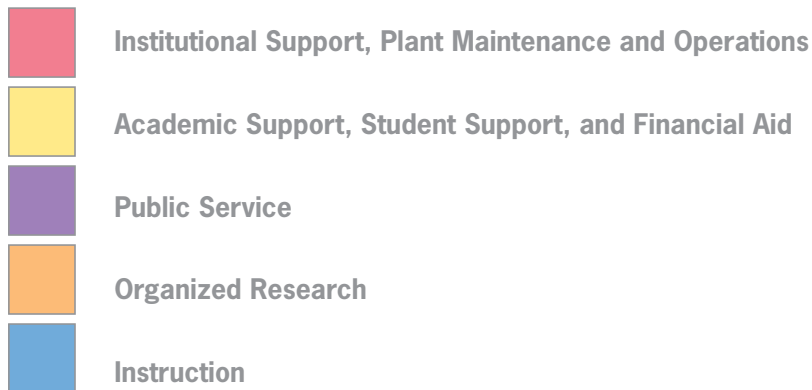
(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|--------------------|------------------|------------------|------------------|------------------|
| Current Funds Revenues | | | | | |
| Instruction | \$490,447 | \$435,839 | \$411,292 | \$383,759 | \$352,711 |
| Organized Research | 213,833 | 186,550 | 174,973 | 161,128 | 152,478 |
| Public Service | 89,663 | 89,906 | 86,062 | 78,678 | 70,106 |
| Academic Support, Student Services, and Financial Aid | 146,575 | 128,107 | 118,351 | 110,863 | 104,051 |
| Institutional Support, Plant Maintenance, and Operations | 123,867 | 117,690 | 122,029 | 116,583 | 107,535 |
| Total Current Funds Expenditures | 1,064,385 | 958,092 | 912,707 | 851,011 | 786,881 |
| Current Funds Mandatory Transfers | 1,346 | 502 | 37 | 43 | 689 |
| Total Current Funds Expenditures and Mandatory Transfers | \$1,065,731 | \$958,594 | \$912,744 | \$851,054 | \$787,570 |



(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|------------------|------------------|------------------|------------------|------------------|
| Current Funds Revenues | | | | | |
| Instruction | \$326,546 | \$301,323 | \$278,587 | \$253,662 | \$241,956 |
| Organized Research | 156,034 | 154,817 | 140,586 | 130,570 | 115,014 |
| Public Service | 65,502 | 68,317 | 62,834 | 56,111 | 52,952 |
| Academic Support, Student Services, and Financial Aid | 90,236 | 83,016 | 77,728 | 71,427 | 64,079 |
| Institutional Support, Plant Maintenance, and Operations | 104,929 | 98,751 | 99,372 | 82,921 | 78,970 |
| Total Current Funds Expenditures | 743,247 | 706,224 | 659,107 | 594,691 | 552,971 |
| Current Funds Mandatory Transfers | 57 | 490 | 1,323 | 2,202 | 2,754 |
| Total Current Funds Expenditures | \$743,304 | \$706,714 | \$660,430 | \$596,893 | \$555,725 |



CURRENT FUNDS REVENUES BY SOURCE

TEN FISCAL YEARS

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--------------------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Current Funds Revenues | | | | | |
| State Appropriations | \$402,205 | \$383,189 | \$382,372 | \$352,283 | \$331,650 |
| Tuition and Fees | 139,319 | 121,507 | 110,400 | 105,745 | 102,277 |
| Federal Contracts and Grants | 311,821 | 276,548 | 259,152 | 231,687 | 221,548 |
| State Contracts and Grants | 52,519 | 44,782 | 37,570 | 31,269 | 26,402 |
| Nongovernmental Contracts and Grants | 70,343 | 56,764 | 51,128 | 44,729 | 40,092 |
| Gifts and Bequests | 80,007 | 53,484 | 46,657 | 44,312 | 38,197 |
| Investment Income | 28,679 | 18,619 | 20,335 | 17,045 | 21,748 |
| Endowment Income | 8,727 | 21,110 | 19,556 | 16,176 | 15,544 |
| Sales and Services | 333,262 | 307,929 | 280,484 | 268,455 | 255,593 |
| Other Revenues | 29,790 | 15,506 | 13,027 | 15,547 | 9,231 |
| Total Current Funds Revenues | \$1,456,672 | \$1,299,438 | \$1,220,681 | \$1,127,248 | \$1,062,282 |

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Current Funds Revenues | % | % | % | % | % |
| State Appropriations | 27.6 | 29.5 | 31.3 | 31.3 | 31.2 |
| Tuition and Fees | 9.6 | 9.4 | 9.0 | 9.4 | 9.6 |
| Federal Contracts and Grants | 21.4 | 21.3 | 21.2 | 20.5 | 20.8 |
| State Contracts and Grants | 3.6 | 3.4 | 3.1 | 2.8 | 2.5 |
| Nongovernmental Contracts and Grants | 4.8 | 4.4 | 4.2 | 4.0 | 3.8 |
| Gifts and Bequests | 5.5 | 4.1 | 3.8 | 3.9 | 3.6 |
| Investment Income | 2.0 | 1.4 | 1.7 | 1.5 | 2.0 |
| Endowment Income | 0.6 | 1.6 | 1.6 | 1.4 | 1.5 |
| Sales and Services | 22.9 | 23.7 | 23.0 | 23.8 | 24.1 |
| Other Revenues | 2.0 | 1.2 | 1.1 | 1.4 | 0.9 |
| Total Current Funds Revenues | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

(percent of total current funds revenues)

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--------------------------------------|------------------|------------------|------------------|------------------|------------------|
| Current Funds Revenues | | | | | |
| State Appropriations | \$308,245 | \$302,337 | \$283,826 | \$270,700 | \$255,003 |
| Tuition and Fees | 88,478 | 81,465 | 75,531 | 66,718 | 60,247 |
| Federal Contracts and Grants | 219,878 | 208,802 | 190,534 | 172,288 | 147,556 |
| State Contracts and Grants | 24,607 | 26,394 | 22,696 | 17,948 | 15,498 |
| Nongovernmental Contracts and Grants | 39,710 | 36,980 | 36,218 | 35,276 | 35,041 |
| Gifts and Bequests | 34,464 | 30,688 | 27,928 | 25,544 | 23,851 |
| Investment Income | 15,274 | 12,726 | 13,748 | 14,534 | 15,828 |
| Endowment Income | 13,599 | 13,798 | 11,895 | 9,212 | 8,040 |
| Sales and Services | 233,888 | 224,600 | 210,767 | 187,390 | 176,297 |
| Other Revenues | 6,526 | 5,679 | 4,246 | 4,632 | 3,847 |
| Total Current Funds Revenues | \$984,669 | \$943,469 | \$877,389 | \$804,242 | \$741,208 |

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Current Funds Revenues | % | % | % | % | % |
| State Appropriations | 31.3 | 32.1 | 32.3 | 33.7 | 34.4 |
| Tuition and Fees | 9.0 | 8.6 | 8.6 | 8.3 | 8.1 |
| Federal Contracts and Grants | 22.3 | 22.1 | 21.7 | 21.4 | 19.9 |
| State Contracts and Grants | 2.5 | 2.8 | 2.6 | 2.2 | 2.1 |
| Nongovernmental Contracts and Grants | 4.0 | 3.9 | 4.1 | 4.4 | 4.8 |
| Gifts and Bequests | 3.5 | 3.3 | 3.2 | 3.2 | 3.2 |
| Investment Income | 1.5 | 1.3 | 1.6 | 1.8 | 2.1 |
| Endowment Income | 1.4 | 1.5 | 1.4 | 1.1 | 1.1 |
| Sales and Services | 23.8 | 23.8 | 24.0 | 23.3 | 23.8 |
| Other Revenues | 0.7 | 0.6 | 0.5 | 0.6 | 0.5 |
| Total Current Funds Revenues | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

(percent of total current funds revenues)

CURRENT FUNDS REVENUES BY SOURCE ADJUSTED FOR INFLATION (1992 DOLLARS)

TEN FISCAL YEARS

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--------------------------------------|--------------------|--------------------|--------------------|------------------|------------------|
| Current Funds Revenues | | | | | |
| State Appropriations | \$316,793 | \$311,619 | \$322,554 | \$303,007 | \$290,064 |
| Tuition and Fees | 109,733 | 98,813 | 93,129 | 90,954 | 89,452 |
| Federal Contracts and Grants | 245,603 | 224,896 | 218,611 | 199,279 | 193,768 |
| State Contracts and Grants | 41,366 | 36,418 | 31,693 | 26,895 | 23,091 |
| Nongovernmental Contracts and Grants | 55,405 | 46,162 | 43,130 | 38,472 | 35,065 |
| Gifts and Bequests | 63,017 | 43,495 | 39,358 | 38,114 | 33,407 |
| Investment Income | 22,589 | 15,141 | 17,154 | 14,661 | 19,021 |
| Endowment Income | 6,874 | 17,167 | 16,497 | 13,913 | 13,595 |
| Sales and Services | 262,491 | 250,416 | 236,606 | 230,904 | 223,544 |
| Other Revenues | 23,464 | 12,610 | 10,989 | 13,372 | 8,074 |
| Total Current Funds Revenues | \$1,147,335 | \$1,056,737 | \$1,029,721 | \$969,571 | \$929,081 |

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Current Funds Revenues | % | % | % | % | % |
| State Appropriations | 27.6 | 29.5 | 31.3 | 31.3 | 31.2 |
| Tuition and Fees | 9.6 | 9.4 | 9.0 | 9.4 | 9.6 |
| Federal Contracts and Grants | 21.4 | 21.3 | 21.2 | 20.5 | 20.9 |
| State Contracts and Grants | 3.6 | 3.4 | 3.1 | 2.8 | 2.5 |
| Nongovernmental Contracts and Grants | 4.8 | 4.4 | 4.2 | 4.0 | 3.8 |
| Gifts and Bequests | 5.5 | 4.1 | 3.8 | 3.9 | 3.6 |
| Investment Income | 2.0 | 1.4 | 1.7 | 1.5 | 2.0 |
| Endowment Income | 0.6 | 1.6 | 1.6 | 1.4 | 1.5 |
| Sales and Services | 22.9 | 23.7 | 23.0 | 23.8 | 24.0 |
| Other Revenues | 2.0 | 1.2 | 1.1 | 1.4 | 0.9 |
| Total Current Funds Revenues | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

(percent of total current funds revenues)

| | | | | | |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|
| Consumer Price Index | 178.0 | 172.4 | 166.2 | 163.0 | 160.3 |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--------------------------------------|------------------|------------------|------------------|------------------|------------------|
| State Appropriations | \$275,788 | \$277,952 | \$268,868 | \$262,826 | \$255,003 |
| Tuition and Fees | 79,162 | 74,894 | 71,550 | 64,777 | 60,247 |
| Federal Contracts and Grants | 196,726 | 191,961 | 180,492 | 167,277 | 147,556 |
| State Contracts and Grants | 22,016 | 24,265 | 21,500 | 17,426 | 15,498 |
| Nongovernmental Contracts and Grants | 35,529 | 33,997 | 34,309 | 34,250 | 35,041 |
| Gifts and Bequests | 30,835 | 28,213 | 26,456 | 24,801 | 23,851 |
| Investment Income | 13,666 | 11,700 | 13,023 | 14,111 | 15,828 |
| Endowment Income | 12,167 | 12,685 | 11,268 | 8,944 | 8,040 |
| Sales and Services | 209,260 | 206,485 | 199,659 | 181,940 | 176,297 |
| Other Revenues | 5,839 | 5,221 | 4,022 | 4,497 | 3,847 |
| Total Current Funds Revenues | \$880,988 | \$867,373 | \$831,147 | \$780,849 | \$741,208 |

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Current Funds Revenues | % | % | % | % | % |
| State Appropriations | 31.2 | 32.1 | 32.3 | 33.7 | 34.4 |
| Tuition and Fees | 9.0 | 8.6 | 8.6 | 8.3 | 8.1 |
| Federal Contracts and Grants | 22.3 | 22.1 | 21.7 | 21.4 | 19.9 |
| State Contracts and Grants | 2.5 | 2.8 | 2.6 | 2.2 | 2.1 |
| Nongovernmental Contracts and Grants | 4.0 | 3.9 | 4.1 | 4.4 | 4.8 |
| Gifts and Bequests | 3.5 | 3.3 | 3.2 | 3.2 | 3.2 |
| Investment Income | 1.6 | 1.3 | 1.6 | 1.8 | 2.1 |
| Endowment Income | 1.4 | 1.5 | 1.4 | 1.1 | 1.1 |
| Sales and Services | 23.8 | 23.8 | 24.0 | 23.3 | 23.8 |
| Other Revenues | 0.7 | 0.6 | 0.5 | 0.6 | 0.5 |
| Total Current Funds Revenues | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

(percent of total current funds revenues)

| | | | | | |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|
| Consumer Price Index | 156.7 | 152.5 | 148.0 | 144.4 | 140.2 |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|

CURRENT FUNDS EXPENDITURES AND MANDATORY TRANSFERS BY FUNCTION

TEN FISCAL YEARS

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|
| Current Funds Expenditures | | | | | |
| Instruction | \$490,447 | \$435,839 | \$411,292 | \$383,759 | \$352,711 |
| Organized Research | 213,833 | 186,550 | 174,973 | 161,128 | 152,478 |
| Public Service | 89,663 | 89,906 | 86,062 | 78,678 | 70,106 |
| Academic Support | 75,226 | 63,528 | 60,384 | 56,528 | 53,663 |
| Student Services | 16,679 | 14,735 | 13,662 | 12,661 | 11,763 |
| Institutional Support | 51,122 | 48,165 | 58,078 | 49,309 | 44,105 |
| Plant Maintenance and Operations | 72,745 | 69,525 | 65,501 | 63,359 | 60,224 |
| Student Financial Aid | 54,670 | 49,844 | 44,305 | 41,674 | 38,625 |
| Auxiliary Enterprises and Internal Services | 135,706 | 127,443 | 121,148 | 112,844 | 101,556 |
| Professional and Clinical Services | 167,703 | 156,522 | 133,057 | 135,099 | 116,393 |
| Other Expenditures and Deductions | 0 | 0 | 0 | 5,974 | 5,669 |
| Total Current Funds Expenditures | 1,367,794 | 1,242,057 | 1,168,462 | 1,101,013 | 1,007,293 |
| Current Funds Mandatory Transfers | 27,481 | 27,620 | 20,079 | 22,852 | 29,008 |
| Total Current Funds Expenditures and Mandatory Transfers | \$1,395,275 | \$1,269,677 | \$1,188,541 | \$1,123,865 | \$1,036,301 |

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|--------------|--------------|--------------|--------------|--------------|
| Current Funds Expenditures | % | % | % | % | % |
| Instruction | 35.2 | 34.3 | 34.6 | 34.1 | 34.0 |
| Organized Research | 15.3 | 14.7 | 14.7 | 14.3 | 14.7 |
| Public Service | 6.4 | 7.1 | 7.2 | 7.0 | 6.8 |
| Academic Support | 5.4 | 5.0 | 5.1 | 5.0 | 5.2 |
| Student Services | 1.2 | 1.2 | 1.2 | 1.1 | 1.1 |
| Institutional Support | 3.7 | 3.8 | 4.9 | 4.4 | 4.3 |
| Plant Maintenance and Operations | 5.2 | 5.5 | 5.5 | 5.7 | 5.8 |
| Student Financial Aid | 3.9 | 3.9 | 3.7 | 3.7 | 3.8 |
| Auxiliary Enterprises and Internal Services | 9.7 | 10.0 | 10.2 | 10.1 | 9.8 |
| Professional and Clinical Services | 12.0 | 12.3 | 11.2 | 12.0 | 11.2 |
| Other Expenditures and Deductions | | | | 0.6 | 0.5 |
| Total Current Funds Expenditures | 98.0 | 97.8 | 98.3 | 98.0 | 97.2 |
| Current Funds Mandatory Transfers | 2.0 | 2.2 | 1.7 | 2.0 | 2.8 |
| Total Current Funds Expenditures and Mandatory Transfers | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

(percent of total current funds expenditures and mandatory transfers)

(in thousands)

| | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|------------------|------------------|------------------|------------------|------------------|
| Current Funds Expenditures | | | | | |
| Instruction | \$326,546 | \$301,323 | \$278,587 | \$253,662 | \$241,956 |
| Organized Research | 156,034 | 154,817 | 140,586 | 130,570 | 115,014 |
| Public Service | 65,502 | 68,317 | 62,834 | 56,111 | 52,952 |
| Academic Support | 47,771 | 43,423 | 40,507 | 35,845 | 32,740 |
| Student Services | 10,986 | 9,998 | 9,191 | 8,585 | 7,624 |
| Institutional Support | 41,500 | 37,698 | 36,800 | 32,118 | 30,097 |
| Plant Maintenance and Operations | 62,402 | 59,662 | 58,447 | 49,606 | 48,552 |
| Student Financial Aid | 31,479 | 29,595 | 28,030 | 26,997 | 23,715 |
| Auxiliary Enterprises and Internal Services | 89,946 | 89,532 | 80,587 | 85,774 | 73,199 |
| Professional and Clinical Services | 108,282 | 99,140 | 97,265 | 85,187 | 74,769 |
| Other Expenditures and Deductions | 1,027 | 1,391 | 4,125 | 1,197 | 345 |
| Total Current Funds Expenditures | 941,475 | 894,896 | 836,959 | \$765,652 | \$700,963 |
| Current Funds Mandatory Transfers | 24,084 | 20,758 | 21,158 | 18,140 | 9,066 |
| Total Current Funds Expenditures and Mandatory Transfers | \$965,559 | \$915,654 | \$858,117 | \$783,792 | \$710,029 |

| | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|--------------|--------------|--------------|--------------|--------------|
| Current Funds Expenditures | % | % | % | % | % |
| Instruction | 33.8 | 32.9 | 32.5 | 32.4 | 34.1 |
| Organized Research | 16.2 | 16.9 | 16.4 | 16.7 | 16.2 |
| Public Service | 6.8 | 7.5 | 7.3 | 7.2 | 7.5 |
| Academic Support | 4.9 | 4.7 | 4.7 | 4.6 | 4.6 |
| Student Services | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 |
| Institutional Support | 4.3 | 4.1 | 4.3 | 4.1 | 4.2 |
| Plant Maintenance and Operations | 6.5 | 6.5 | 6.8 | 6.3 | 6.8 |
| Student Financial Aid | 3.3 | 3.2 | 3.3 | 3.4 | 3.3 |
| Auxiliary Enterprises and Internal Services | 9.3 | 9.8 | 9.4 | 10.9 | 10.3 |
| Professional and Clinical Services | 11.2 | 10.8 | 11.3 | 10.9 | 10.5 |
| Other Expenditures and Deductions | 0.1 | 0.2 | 0.4 | 0.1 | 0.1 |
| Total Current Funds Expenditures | 97.5 | 97.7 | 97.5 | 97.7 | 98.7 |
| Current Funds Mandatory Transfers | 2.5 | 2.3 | 2.5 | 2.3 | 1.3 |
| Total Current Funds Expenditures and Mandatory Transfers | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

(percent of total current fund expenditures and mandatory transfers)

TEN-YEAR SUMMARY OF RATIOS

RATIO OF TOTAL CURRENT REVENUES TO TOTAL CURRENT EXPENDITURES

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|----------------|----------------|----------------|----------------|----------------|
| Total Current Revenues | \$1,456,672 | \$1,299,438 | \$1,220,681 | \$1,127,248 | \$1,062,282 |
| Total Current Expenditures and Mandatory Transfers | \$1,395,275 | \$1,269,677 | \$1,188,541 | \$1,123,865 | \$1,036,301 |
| Ratio | 104.40% | 102.34% | 102.70% | 100.30% | 102.51% |

This ratio indicates the percentage of current funds revenues that remain after all current funds expenditures and mandatory transfers are applied. A percentage greater than 100% indicates a surplus for the year. The larger the surplus, the stronger the institution's financial position as a result of the year's operations. Large deficits are usually a bad sign, particularly if they occur in successive years. A pattern of large deficits can reduce an institution's financial strength. Such a pattern is a warning signal that corrective action should be taken.

RATIO OF AVAILABLE FUNDS TO EDUCATIONAL AND GENERAL EXPENDITURES AND MANDATORY TRANSFERS

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|------------------|------------------|------------------|------------------|------------------|
| Current Fund Balance - General | \$115,263 | \$86,061 | \$60,828 | \$54,643 | \$60,437 |
| Current Fund Balance - Proprietary | 170,668 | 162,193 | 165,090 | 157,697 | 154,264 |
| Quasi Endowment Fund Balance - Unrestricted | 106,682 | 121,441 | 98,556 | 85,787 | 48,704 |
| Total Availability | \$392,613 | \$369,695 | \$324,474 | \$298,127 | \$263,405 |
| Total Availability | \$392,613 | \$369,695 | \$324,474 | \$298,127 | \$263,405 |
| Educational and General Expenditures and Mandatory Transfers | \$1,091,866 | \$985,712 | \$934,336 | \$869,948 | \$812,682 |
| Ratio | 35.96% | 37.51% | 34.73% | 34.27% | 32.41% |

This ratio measures the size of the institution's financial reserves. Increasing ratios indicate better preparation for financial disruptions. The University receives its state appropriations on a quarterly allotment basis and state appropriations are not accrued at year end to finance accrued expenses.

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|----------------|----------------|----------------|----------------|----------------|
| Total Current Revenues | \$984,669 | \$943,469 | \$877,389 | \$804,242 | \$741,208 |
| Total Current Expenditures and Mandatory Transfers | \$965,559 | \$915,654 | \$858,117 | \$783,792 | \$710,029 |
| Ratio | 101.98% | 103.04% | 102.25% | 102.61% | 104.39% |

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|------------------|------------------|------------------|------------------|------------------|
| Current Fund Balance - General | \$53,902 | \$49,726 | \$44,104 | \$37,536 | \$29,681 |
| Current Fund Balance - Proprietary | 149,134 | 140,429 | 127,098 | 116,643 | 111,371 |
| Quasi Endowment Fund Balance - Unrestricted | 35,640 | 34,988 | 36,656 | 36,066 | 33,761 |
| Total Availability | \$238,676 | \$225,143 | \$207,858 | \$190,245 | \$174,813 |
| Total Availability | \$238,676 | \$225,143 | \$207,858 | \$190,245 | \$174,813 |
| Educational and General Expenditures and Mandatory Transfers | \$766,304 | \$725,591 | \$676,140 | \$611,634 | \$561,716 |
| Ratio | 31.15% | 31.03% | 30.74% | 31.10% | 31.12% |

TEN-YEAR SUMMARY OF RATIOS

RATIO OF EXPENDABLE FUND BALANCE TO TOTAL EXPENDITURES AND MANDATORY TRANSFERS

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--|--------------------|------------------|------------------|------------------|------------------|
| Current Fund Balance - General | \$115,263 | \$86,061 | \$60,828 | \$54,643 | \$60,437 |
| Current Fund Balance - Proprietary | 170,668 | 162,193 | 165,090 | 157,697 | 154,264 |
| Current Fund Balance - Restricted | 207,040 | 147,942 | 137,437 | 112,855 | 94,072 |
| Quasi Endowment Fund Balance | 489,126 | 493,209 | 161,984 | 143,043 | 92,180 |
| Unexpended Plant Fund Balance | 63,159 | 55,581 | 86,670 | 72,332 | 61,063 |
| Debt Service Fund Balance | 24,761 | 28,485 | 28,628 | 32,329 | 26,454 |
| Total Expendable Fund Balance | \$1,070,017 | \$973,471 | \$640,637 | \$572,899 | \$488,470 |
| Total Expendable Fund Balance | \$1,070,017 | \$973,471 | \$640,637 | \$572,899 | \$488,470 |
| Total Current Expenditures and Mandatory Transfers | \$1,395,275 | \$1,269,677 | \$1,188,541 | \$1,123,865 | \$1,036,301 |
| Ratio | 76.69% | 76.67% | 53.90% | 50.98% | 47.14% |

This ratio is an important measure of financial strength relative to institutional operating size. Expendable fund balances should increase at least proportionally as the rate of growth of operating size. If this is not the case, the same dollar amount of expendable fund balances will provide less margin of protection against adversity as the institution grows in dollar level of expenditure.

RATIO OF INSTRUCTION AND ACADEMIC SUPPORT TO TOTAL EDUCATIONAL AND GENERAL EXPENDITURES LESS RESTRICTED SCHOLARSHIPS

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--|--------------------|------------------|------------------|------------------|------------------|
| Instruction | \$490,447 | \$435,839 | \$411,292 | \$383,759 | \$352,711 |
| Other Academic Support | 75,226 | 63,528 | 60,384 | 56,528 | 53,663 |
| Total Instruction and Academic Support | \$565,673 | \$499,367 | \$471,676 | \$440,287 | \$406,374 |
| Educational and General Expenditures and Mandatory Transfers | \$1,065,655 | \$958,594 | \$914,294 | \$847,139 | \$784,364 |
| Less: Restricted Scholarships | 25,853 | 24,953 | 19,945 | 21,489 | 20,705 |
| Total Educational and General Expenditures less Restricted Scholarships | \$1,039,802 | \$933,641 | \$894,349 | \$825,650 | \$763,659 |
| Total Instruction and Academic Support | \$565,673 | \$499,367 | \$471,676 | \$440,287 | \$406,374 |
| Total Educational and General Expenditures less Restricted Scholarships | \$1,039,802 | \$933,641 | \$894,349 | \$825,650 | \$763,659 |
| Ratio | 54.40% | 53.49% | 52.74% | 53.33% | 53.21% |

This ratio indicates whether the institution has been maintaining the allocation of resources to the academic program. If financial resources are decreasing, the instruction and academic support proportion may also decrease due to greater demands for administrative expenditures, such as admissions or fund raising. A decrease in instruction and academic support expenditures as a proportion of the operating budget may not indicate an absolute decline, specifically when there is an alternative increase in quality; however, such a change in quality is difficult to measure.

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|------------------|------------------|------------------|------------------|------------------|
| Current Fund Balance - General | \$53,902 | \$49,726 | \$44,104 | \$37,536 | \$29,681 |
| Current Fund Balance - Proprietary | 149,134 | 140,429 | 127,098 | 116,643 | 111,371 |
| Current Fund Balance - Restricted | 92,510 | 91,586 | 77,839 | 66,205 | 53,318 |
| Quasi Endowment Fund Balance | 71,023 | 64,935 | 66,525 | 63,364 | 56,024 |
| Unexpended Plant Fund Balance | 55,763 | 48,658 | 34,830 | 20,573 | 9,657 |
| Debt Service Fund Balance | 10,833 | 17,073 | 16,421 | 16,244 | 18,300 |
| Total Expendable Fund Balance | \$433,165 | \$412,407 | \$366,817 | \$320,565 | \$278,351 |
| Total Expendable Fund Balance | \$433,165 | \$412,407 | \$366,817 | \$320,565 | \$278,351 |
| Total Current Expenditures and Mandatory Transfers | \$965,559 | \$915,654 | \$858,117 | \$783,792 | \$710,029 |
| Ratio | 44.86% | 45.04% | 42.75% | 40.90% | 39.20% |

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--|------------------|------------------|------------------|------------------|------------------|
| Instruction | \$326,546 | \$301,323 | \$278,587 | \$253,662 | \$241,956 |
| Other Academic Support | 47,771 | 43,423 | 40,507 | 35,845 | 32,740 |
| Total Instruction and Academic Support | \$374,317 | \$344,746 | \$319,094 | \$289,507 | \$274,696 |
| Educational and General Expenditures and Mandatory Transfers | \$742,277 | \$705,323 | \$656,305 | \$595,696 | \$555,404 |
| Less: Restricted Scholarships | 19,021 | 17,713 | 17,439 | 17,116 | 14,940 |
| Total Educational and General Expenditures less Restricted Scholarships | \$723,256 | \$687,610 | \$638,866 | \$578,580 | \$540,464 |
| Total Instruction and Academic Support | \$374,317 | \$344,746 | \$319,094 | \$289,507 | \$274,696 |
| Total Educational and General Expenditures less Restricted Scholarships | \$723,256 | \$687,610 | \$638,866 | \$578,580 | \$540,464 |
| Ratio | 51.75% | 50.14% | 49.95% | 50.04% | 50.83% |

TEN-YEAR SUMMARY OF RATIOS

EDUCATIONAL EXPENDITURES PER STUDENT

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--|--------------------|------------------|------------------|------------------|------------------|
| Total Current Fund Expenditures | \$1,367,794 | \$1,242,057 | \$1,168,462 | \$1,101,013 | \$1,007,293 |
| Plus: Current Fund Mandatory Transfers | 27,481 | 27,620 | 20,079 | 22,852 | 29,007 |
| Less: Student Financial Aid | 54,670 | 49,844 | 44,305 | 41,674 | 38,625 |
| Less: Auxiliary Enterprises Expenditures | 127,425 | 121,969 | 115,280 | 106,837 | 96,674 |
| Less: Professional Clinical Services | 167,703 | 156,522 | 133,057 | 135,099 | 116,393 |
| Total Educational Expenditures | \$1,045,477 | \$941,342 | \$895,899 | \$840,255 | \$784,608 |
| Total Educational Expenditures | \$1,045,477 | \$941,342 | \$895,899 | \$840,255 | \$784,608 |
| Undergraduate, Graduate and Professional FTE | 23,000 | 22,761 | 21,940 | 21,794 | 21,709 |
| Educational Expenditures per Student (in thousands) | \$45.5 | \$41.4 | \$40.8 | \$38.6 | \$36.1 |

This ratio measures average educational expenditures incurred per student FTE.

RATIO OF NET GAIN IN ENDOWMENT ASSETS

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--|-----------------|------------------|-----------------|-----------------|-----------------|
| Year - End Endowment Assets (Market Value) | \$768,816 | \$750,321 | \$593,373 | \$554,029 | \$465,152 |
| Year - Begin Endowment Assets (Market Value) | 750,321 | 593,373 | 554,029 | 465,152 | 390,146 |
| Yearly Change | \$18,495 | \$156,948 | \$39,344 | \$88,877 | \$75,006 |
| Yearly Change | \$18,495 | \$156,948 | \$39,344 | \$88,877 | \$75,006 |
| Year - Begin Endowment Assets (Market Value) | \$750,321 | \$593,373 | \$554,029 | \$465,152 | \$390,146 |
| Ratio | 2.46% | 26.45% | 7.10% | 19.11% | 19.23% |

This ratio measures the growth of endowment assets resulting directly from investment policies and/or gifts. If the ratios are increasing, the endowment assets are growing through efficient investment of the endowment funds and/or additional gifts and transfers to the endowment funds.

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--|------------------|------------------|------------------|------------------|------------------|
| Total Current Fund Expenditures | \$941,475 | \$894,896 | \$836,959 | \$765,652 | \$700,963 |
| Plus: Current Fund Mandatory Transfers | 24,084 | 20,758 | 21,158 | 18,140 | 9,066 |
| Less: Student Financial Aid | 31,479 | 29,595 | 28,030 | 26,997 | 23,715 |
| Less: Auxiliary Enterprises Expenditures | 88,032 | 83,823 | 76,560 | 81,907 | 56,996 |
| Less: Professional Clinical Services | 108,282 | 99,140 | 97,265 | 85,187 | 74,769 |
| Total Educational Expenditures | \$737,766 | \$703,096 | \$656,262 | \$589,701 | \$554,549 |
| Total Educational Expenditures | \$737,766 | \$703,096 | \$656,262 | \$589,701 | \$554,549 |
| Undergraduate, Graduate and Professional FTE | 21,961 | 21,918 | 21,758 | 21,398 | 21,391 |
| Educational Expenditures per Student (in thousands) | \$33.6 | \$32.1 | \$30.2 | \$27.6 | \$25.9 |

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|
| Year - End Endowment Assets (Market Value) | \$390,146 | \$335,076 | \$293,214 | \$223,948 | \$209,547 |
| Year - Begin Endowment Assets (Market Value) | 335,076 | 293,214 | 223,948 | 209,547 | 181,413 |
| Yearly Change | \$55,070 | \$41,862 | \$69,266 | \$14,401 | \$28,134 |
| Yearly Change | \$55,070 | \$41,862 | \$69,266 | \$14,401 | \$28,134 |
| Year - Begin Endowment Assets (Market Value) | \$335,076 | \$293,214 | \$223,948 | \$209,547 | \$181,413 |
| Ratio | 16.44% | 14.28% | 30.93% | 6.87% | 15.51% |

TEN-YEAR SUMMARY OF RATIOS

RATIO OF UNRESTRICTED OPERATING RESOURCES TO DEBT

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--|------------------|------------------|------------------|------------------|------------------|
| Current Fund Balance – General | \$115,263 | \$86,061 | \$60,828 | \$54,643 | \$60,437 |
| Current Fund Balance – Proprietary | 170,668 | 162,193 | 165,090 | 157,697 | 154,264 |
| Unrestricted Quasi Endowment Fund Balance | 106,682 | 121,441 | 98,556 | 85,787 | 48,704 |
| Unrestricted Unexpended Plant Fund Balance | 1,433 | 1,828 | 1,837 | 6,291 | 3,112 |
| Unrestricted Debt Service Fund Balance | 5,892 | 6,725 | 5,211 | 11,305 | 7,453 |
| Total Expendable Fund Balance | \$399,938 | \$378,248 | \$331,522 | \$315,723 | \$273,970 |
| Total Expendable Fund Balance | \$399,938 | \$378,248 | \$331,522 | \$315,723 | \$273,970 |
| Total Debt Outstanding | \$396,805 | \$306,603 | \$286,366 | \$279,096 | \$272,965 |
| Ratio | 100.79% | 123.37% | 115.77% | 113.12% | 100.37% |

This ratio is a conservative measure of resources available to investors from unrestricted expendable reserves that excludes amounts designated for long-term investment.

RATIO OF TOTAL RESOURCES TO DEBT

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--------------------------------------|--------------------|--------------------|--------------------|------------------|------------------|
| Current Fund Balance – General | \$115,263 | \$86,061 | \$60,828 | \$54,643 | \$60,437 |
| Current Fund Balance – Proprietary | 170,668 | 162,193 | 165,090 | 157,697 | 154,264 |
| Current Fund Balance – Restricted | 207,040 | 147,942 | 137,437 | 112,855 | 94,072 |
| Endowment Fund Balance | 731,170 | 727,798 | 587,946 | 547,750 | 376,052 |
| Unexpended Plant Fund Balance | 63,159 | 55,581 | 86,670 | 72,332 | 61,063 |
| Debt Service Fund Balance | 24,761 | 28,485 | 28,628 | 32,329 | 26,454 |
| Total Expendable Fund Balance | \$1,312,061 | \$1,208,060 | \$1,066,599 | \$977,606 | \$772,342 |
| Total Expendable Fund Balance | \$1,312,061 | \$1,208,060 | \$1,066,599 | \$977,606 | \$772,342 |
| Total Debt Outstanding | \$396,805 | \$306,604 | \$286,366 | \$279,096 | \$272,965 |
| Ratio | 330.66% | 394.01% | 372.46% | 350.28% | 282.95% |

This ratio is a broad measure of resources to debt that includes the corpus of endowed contributions.

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--|------------------|------------------|------------------|------------------|------------------|
| Current Fund Balance - General | \$53,902 | \$49,726 | \$44,104 | \$37,536 | \$29,681 |
| Current Fund Balance - Proprietary | 149,134 | 140,429 | 127,098 | 116,643 | 111,371 |
| Unrestricted Quasi Endowment Fund Balance | 35,640 | 34,988 | 36,656 | 36,066 | 33,761 |
| Unrestricted Unexpended Plant Fund Balance | 3,645 | 4,658 | 4,366 | 5,178 | 1,872 |
| Unrestricted Debt Service Fund Balance | (6,238) | 2,298 | 3,798 | 7,901 | 9,327 |
| Total Expendable Fund Balance | \$236,083 | \$232,099 | \$216,022 | \$203,324 | \$186,012 |
| Total Expendable Fund Balance | \$236,083 | \$232,099 | \$216,022 | \$203,324 | \$186,012 |
| Total Debt Outstanding | \$232,028 | \$238,176 | \$225,834 | \$230,825 | \$222,548 |
| Ratio | 101.75% | 97.45% | 95.66% | 88.09% | 83.58% |

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--------------------------------------|------------------|------------------|------------------|------------------|------------------|
| Current Fund Balance - General | \$53,902 | \$49,726 | \$44,104 | \$37,536 | \$29,681 |
| Current Fund Balance - Proprietary | 149,134 | 140,429 | 127,098 | 116,643 | 111,371 |
| Current Fund Balance - Restricted | 92,510 | 91,586 | 77,839 | 66,205 | 53,318 |
| Endowment Fund Balance | 303,674 | 273,448 | 270,211 | 212,158 | 191,497 |
| Unexpended Plant Fund Balance | 55,763 | 48,658 | 34,830 | 20,573 | 9,657 |
| Debt Service Fund Balance | 10,833 | 17,073 | 16,421 | 16,244 | 18,300 |
| Total Expendable Fund Balance | \$665,816 | \$620,920 | \$570,503 | \$469,359 | \$413,824 |
| Total Expendable Fund Balance | \$665,816 | \$620,920 | \$570,503 | \$469,359 | \$413,824 |
| Total Debt Outstanding | \$232,028 | \$238,176 | \$225,834 | \$230,825 | \$222,548 |
| Ratio | 286.96% | 260.70% | 252.62% | 203.34% | 185.95% |

GROSS DEBT SERVICE COVERAGE

TEN FISCAL YEARS

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|
| General Fund Increase in Fund Equity | \$29,202 | n/a | n/a | n/a | n/a |
| General Fund Mandatory Transfers | 1,270 | n/a | n/a | n/a | n/a |
| Proprietary Fund Increase in Fund Equity | 8,475 | (\$2,897) | \$7,393 | \$2,699 | \$5,130 |
| Proprietary Fund Mandatory Transfers | 26,135 | 27,118 | 20,042 | 22,809 | 28,318 |
| Total Resources | \$65,082 | \$24,221 | \$27,435 | \$25,508 | \$33,448 |
| | | | | | |
| Total Debt Service Requirements | \$27,250 | \$22,952 | \$21,136 | \$19,547 | \$19,342 |
| Total Resources | \$65,082 | \$24,221 | \$27,435 | \$25,508 | \$33,448 |
| | | | | | |
| Coverage | 2.39 | 1.06 | 1.30 | 1.30 | 1.73 |

RATIO OF DEBT SERVICES TO CURRENT EXPENDITURES

TEN FISCAL YEARS

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 2001 | 2000 | 1999 | 1998 | 1997 |
|------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Debt Service Requirements | \$27,250 | \$22,952 | \$21,136 | \$19,547 | \$19,342 |
| Current Funds Expenditures | \$1,367,794 | \$1,242,057 | \$1,168,462 | \$1,101,013 | \$1,007,293 |
| | | | | | |
| Ratio | 1.99% | 1.85% | 1.81% | 1.78% | 1.92% |

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|
| General Fund Increase in Fund Equity | n/a | n/a | n/a | n/a | n/a |
| General Fund Mandatory Transfers | n/a | n/a | n/a | n/a | n/a |
| Proprietary Fund Increase in Fund Equity | \$8,705 | \$13,331 | \$10,455 | \$5,272 | \$17,421 |
| Proprietary Fund Mandatory Transfers | 24,027 | 20,268 | 19,835 | 15,938 | 6,312 |
| Total Resources | \$32,732 | \$33,599 | \$30,290 | \$21,210 | \$23,733 |
| Total Debt Service Requirements | \$19,353 | \$20,154 | \$19,058 | \$15,642 | \$14,719 |
| Total Resources | \$32,732 | \$33,599 | \$30,290 | \$21,210 | \$23,733 |
| Coverage | 1.69 | 1.67 | 1.59 | 1.36 | 1.61 |

(in thousands)

| FOR THE FISCAL YEAR ENDED JUNE 30, | 1996 | 1995 | 1994 | 1993 | 1992 |
|------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Debt Service Requirements | \$19,353 | \$20,154 | \$19,058 | \$15,642 | \$14,719 |
| Current Funds Expenditures | \$941,475 | \$ 894,896 | \$836,959 | \$765,652 | %700,963 |
| Ratio | 2.06% | 2.25% | 2.28% | 2.04% | 2.10% |



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